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United States
Circuit Court of Appeals

For the Ninth Circuit

WEST COAST LIFE INSURANCE COMPANY, a corporation, PACIFIC NATIONAL BANK OF SAN FRANCISCO, a national banking association, et al.,

Appellants,

vs.

MERCED IRRIGATION DISTRICT,

Appellee.

PETITION FOR REHEARING

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No. 9242

United States Circuit Court of Appeals

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West Coast Life Insurance Company, a corporation, Pacific National Bank of San Francisco, a national banking association, et al.,

Appellants,

vs.

Merced Irrigation District,

Appellee.

PETITION FOR REHEARING

We respectfully petition this Court for a rehearing of this appeal upon the following grounds:

INTRODUCTION

The only points here discussed are those which, we believe, particularly require discussion in light of the Court's opinion, although we urge the Court to reconsider the other points which we have heretofore advanced.

I.

AFFIRMANCE OF THE DECREE SHOULD IN ANY EVENT BE ON CONDITION OF PAYMENT TO OBJECTING BONDHOLDERS OF 4% INTEREST

We made three arguments in support of the proposition that the plan is unfair because the objecting bondholders get only the principal amount offered by the plan without any interest whatever.

The Court has considered two of our three arguments, namely, (1) that the plan is discriminatory between consenting and non-consenting bondholders because the former were paid a total of $168,000 in interest (R. 368), and (2) the argument that the plan is unfair because the RFC has received 4% interest from the time of its disbursement, i. e., from October 4, 1935 (R. 344), namely, a total of 20% up to October 4, 1940.

The Court does not mention, however, our principal argument in connection with denial of interest to objecting bondholders, namely, this: As was stated at the oral argument:

> "In this case the bondholders were told, 'If you have the temerity to question our plan, you must forego any income on your money for such time as it takes to litigate.' * * * The bondholders here were confronted by an agency of the State of California and an agency of the Federal Government, which looked the bondholder in the eye and said, 'Here is what we offer you. Now, what are you going to do about it?'

> "The penalty for questioning their proposal was loss of income for such time as it might take to litigate it, plus $9.18 per bond."

And as was said in the main brief for appellants (p. 61):

> "No compensation is allowed by the plan to appellants for the period they have waited, although during most of this time there was no statute in effect under which this district could have compelled acceptance of its plan.
>
> "In the case of *In re James Irrigation District,* 25 Fed. Supp. 974 at 975, it was held that interest paid to consenting creditors should also be paid to non-consenting creditors.
>
> "Appellants should not be penalized for resisting the prior proceeding, which was determined to be void as they contended. Delayed payment is vitally different from prompt payment:
>
> "*State v. City of New Orleans,* 102 U. S. 203.
>
> "The plan in that case was approved subject to such provision being made."

We earnestly submit that denial of any interest to objecting bondholders makes the plan unfair; and if confirmation of the plan is to stand, the decree should make the confirmation conditional upon payment to objecting bondholders of 4% interest from the time of the first disbursement to consenting bondholders. This for the following reasons:

(1) In the first place, there is no question but what a bankruptcy court, as a court of equity, has

power to impose conditions, on equitable principles, so long as those principles are not inconsistent with the Bankruptcy Act.

The principle that an equitable decree must not be unfair is not only a fundamental principle of equity but an express command of this statute. As was said in

> *Securities & Exchange Commission v. U. S. Realty & Improvement Company,* ..... U. S. .....; 60 S. Ct. Rep. 1044, 1053-4:
>
> "A bankruptcy court is a court of equity, §2, 11 U. S. C. A. § 11, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act. [Authorities.] A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition * * * we cannot assume that Congress has disregarded well settled principles of equity, the more so when Congress itself has provided that the relief to be given shall be 'fair and equitable and feasible.' Good sense and legal tradition alike enjoin that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part."

This being true, this Court's power to grant the relief on conditions which will make its operation fair and equitable is not only within its power, but a part of its duty.

(2) Secondly, and apart from the foregoing, we submit that the Act should not be construed as author-

izing a plan (as here) whereby the bondholders' unquestioned right to object to the plan, and to ask for judicial examination of its fairness, is seriously handicapped and penalized by the plan itself. This plan tells the bondholder that he must accept the amount offered in full satisfaction of an undisputed debt, or else forego the enjoyment thereof for such number of years as it will take to litigate it, receiving no interest whatsoever in the meantime. Such a plan is contrary, we submit, to the purposes of the statute, which certainly was not intended to permit petitioning districts to subject their bondholders to substantial coercion in order to compel acceptance of plans believed by the bondholders to be unfair. See:

Manning v. Brandon Corporation, 163 So. Car. 178, 161 S. E. 405.

(3) It is important to observe that payment of interest to the objecting bondholders *will not require the District to make any payment whatever beyond what the plan itself contemplated.* The central theory of the plan is that the District proposes to borrow money at 4% wherewith to discharge its bonds at 51.501¢ on the dollar. The actual operation of the plan under the decree of the Court is that the District saves 4% for five years on the entire amount admittedly owing to the objecting bondholders (by the very terms of the plan) from the beginning; and they in turn are penalized in an equal amount by being deprived of both the use of their money and interest thereon during the entire period of litigation.

Surely the District should not thus profit, nor should the objecting bondholders thus suffer as compared with consenting bondholders, solely because they objected to the plan on the ground that they believed it to be unfair.

(4) The most obvious analogy to the present situation in private law is the effect of a tender as stopping interest. It is Hornbook law that a conditional tender does not stop the running of interest.

6 *Williston on Contracts* (Rev. Ed.) 5144.

More particularly, a tender on condition that the creditor surrender a right then in litigation between the parties is no tender at all, and is ineffective, therefore, to stop the running of interest.

Cameron County Improvement Dist. No. 8 v. De la Vergne, 100 F. (2d) 523.

So here, the plan was in substance a tender to the bondholders of much less than half the amount owing to them (taking account of unpaid interest), made on condition that the amount tendered be accepted in full satisfaction of the debt. Whether or not the bondholders were bound to accept the amount tendered as full satisfaction (i. e., whether or not the plan was "fair") was, as a matter of law, a question which the bondholders could with entire justice and propriety dispute.

For the foregoing reasons we submit that to say that the offer of the plan stopped the running of the interest on the amount ultimately found owing is

contrary to the reasonable construction of the statute, is eminently unfair and inequitable, and is contrary to analogous rules of law.

We earnestly submit, therefore, that if the plan is to be confirmed, this Court's decree should in any event impose, as a condition to affirmance, that the objecting bondholders be paid interest at 4% from the date of the original disbursement by the RFC (October 4, 1935, R. 344) to the date of actual payment.

II.

RES JUDICATA

This Court seems to announce two principal propositions concerning the plea of *res judicata*:

1. The Court seems to say (pp. 8-9) that the record does not establish the fact that this Court held, in the prior action between these parties, that the first Municipal Bankruptcy Act was beyond the power of Congress to enact.

2. The Court seems to say (pp. 6-8, 9-11, 46-8) that the prior adjudication between these parties that the first Municipal Bankruptcy Act was void, is not *res judicata* of the proposition that the present Municipal Bankruptcy Act is void, because the two Acts are distinguishable.

It is, we submit, clear that the Supreme Court of the United States in *Ashton v. Cameron County Improvement District Number One,* 298 U. S. 513, placed

its decision that the first Municipal Bankruptcy Act was beyond the powers of Congress to enact on the ground that the bankruptcy clause of the Constitution does not confer power upon the Congress to scale down the debts of public corporations such as improvement districts and irrigation districts. The Court's language is unequivocal:

> "We need not consider this Act in detail or undertake definitely to classify it. The evident intent was to authorize a federal court to require objecting creditors to accept an offer by a public corporation to compromise, scale down, or repudiate its indebtedness without the surrender of any property whatsoever. * * *
>
> "Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. * * *
>
> "The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify or impair the obligation of their contracts. The statute before us expresses this design in plain terms. It undertakes to extend the supposed power of the Federal Government incident to bankruptcy over any embarrassed district which may apply to the Court. * * *"

Upon this ground the Court held the statute void. Not, that is to say, upon the ground of any of its particular provisions, but upon the ground of its ultimate purpose (identical with the purpose of the present statute), namely (in the language of the Court):

> "to authorize a federal court to require objecting creditors to accept an offer by a public corporation to compromise, scale down, or repudiate its indebtedness without the surrender of any property whatsoever."

The ultimate proposition at law, therefore, upon which the decision of the *Ashton* case rested, was the proposition that the Congress cannot scale down the debts of such corporations as that here involved.

If this is true, it certainly cannot be said that slight difference of detail between the two statutes has any effect on the situation. The rule of law announced and applied in the *Ashton* case, if applied in the present case, calls for the conclusion that the second statute is void. Since the rule of law announced in the *Ashton* case is *res judicata* between these parties, it follows that this proceeding, which cannot lie unless the Congress has power to scale down the debts of the petitioner, should be dismissed.

We turn now to the other proposition which this Court seems to announce, namely, that it does not appear that it held the first Act to be beyond the powers of Congress, in the previous suit between these parties.

We respectfully submit that no one can doubt the ground of this Court's decision in the prior suit between these parties reversing the judgment of the trial court and directing dismissal of the proceeding. One ground and one only was urged upon the Court, namely, that the proceeding would not lie unless the

statute upon which it rested was a valid enactment, and that the Supreme Court had held that statute to be void. (R. 333-337) This Court said that upon consideration of the motion, the judgment should be reversed with directions to dismiss. (R. 338) This Court knows, judicially and in fact, that it granted the motion because it felt bound by the reasoning and decision of the United States Supreme Court in the *Ashton* case. It follows that the ground upon which the first proceeding between these parties was dismissed was the ground upon which the Supreme Court of the United States decided the *Ashton* case.

We submit that it is unfair to appellants for the Court to cast doubt upon the reason for its first decision.

Blair v. Commissioner, 300 U. S. 5.

Both the majority and concurring opinions rely on *Blair v. Commissioner,* as establishing a rule whereby the first decision between these parties is not *res judicata* of the power of Congress to scale down the debts of the Merced Irrigation District.

The Court's analysis of the *Blair* case, if accepted, simply abolishes the rule of *res judicata* in all cases where a decision between other parties establishes a rule of law different from the rule of an earlier case which would otherwise be *res judicata.*

The intervention of the second Bankruptcy Act is plainly not relevant because no such statute was involved in the *Blair* case, and the *Tait* case which the Court there distinguished did involve an intervening

statute, as have many other cases which certainly are not overruled by *Blair v. Commissioner.*

The fact is, we submit, that the decision of *Blair v. Commissioner* deals with a very special situation, namely, the situation where a federal court, having announced its views concerning what the State law is in an earlier decision, finds, in a later case on a different cause of action between the same parties, either that it was mistaken or that the State law has changed.

The vital point is that the federal courts cannot finally declare the law of a State. A State court decision, contradicting an earlier federal decision as to what the State law is, must be accepted and applied in later cases in the federal courts.

In the present case, however, a very different situation is presented. In the *Ashton* case, the Supreme Court of the United States construed the Constitution, and determined that the Congress had no power to enact a statute providing for an enforced scaling down of the debts of irrigation and similar districts. Thereafter, in the *Merced* case, this Court accepted (as it was bound to), and applied that rule of law between these parties; and thereafter the Supreme Court of the United States made that decision final by denying certiorari. Later, the Supreme Court held in litigation between other parties that Congress does have power to do what had been attempted in the first case, thereby creating a typical situation wherein the rule of *res judicata* becomes an operative factor. This Court's decision herein amounts to the proposition

that since the time of the first decision between these parties, the Constitution of the United States has been amended. If it had been, then the *Blair* case would be precisely in point; but no such amendment exists in fact.

Until it is held that decisions of the Supreme Court on constitutional questions amount to amendments of the Constitution, and not merely to judicial decisions of controversies between particular litigants, it will not be true that litigants must re-litigate rights governed by rules of constitutional law whenever the Supreme Court has changed, or appears likely to change, its views.

III.

FAIRNESS OF THE PLAN

Several considerations must be mentioned:

(1) The beginning of the Court's discussion of fairness seems to assume that the plan is fair unless the District could pay its debts in full. The fact is, of course, that the plan is not fair if the District could reasonably pay substantially more than it offers.

The remaining comments on the Court's treatment of fairness can be conveniently stated in the form of contrasts between the Court's opinion in this case and its opinion in the case of *Fano v. Newport Heights Irrigation District, No. 9147,* decided the same day.

(2) In the *Fano* case, this Court emphasizes and gives much weight to the fact that the District there

involved, although unable to meet its debts as they mature, owned "assets in value many times the indebtedness". (Opinion p. 5) In the *Merced* case, we have pointed out at length the indisputable fact that the District's assets far exceed its liabilities. The Court does not mention the matter.

(3) In the *Fano* case, this Court makes much of the fact that the percentage of delinquency in payment of assessments for certain years was small, and accepts this circumstance as strong evidence that the District could have levied larger assessments, and therefore could have paid more than the amount of the assessments actually levied would indicate. In the *Merced* case, we have shown at length that during the entire 18 years of the Merced Irrigation District's existence the landowners have actually paid in assessments an average of $700,421 a year; and that this amount is sufficient to amortize and discharge bonds (bearing interest and with maturities like those offered by the plan) having a total capital sum of from $4,800,000 to $8,400,000 more than the plan offers. Payment of assessments in the future equal to the average assessments actually paid in the past (during a period of unprecedented depression) will amortize a bond issue of $4,800,000 more than the plan offers, even if we accept the District's indefensibly high figure of $500,000 per year for operating expenses and also accept the District's indefensibly low figure of $445,000 per year power revenue. It follows that taking the assessments actually and admittedly paid in the past, and taking the District's own contentions as to its expenses and its other revenues, the

plan is grossly unfair under the reasoning of this Court in the *Fano* case. The Court does not mention our discussion of this aspect of the case. (See the summary of our argument on this point in the printed oral argument of appellants, pages 11-18.)

(4) In the *Fano* case, this Court condemned the District for relying on large capital expenditures as a basis for its contention that its ability to pay was small. In the present case, we have shown that the Merced District has in the past, indeed since its first permanent default, made enormous expenditures by way of capital betterments; and that in computing its operating expenses for the future, it represents and contends that it may count as operating expenses (to be paid before its debts are paid), capital expenditures of $125,000 per year, which amount is nearly one-half of its actual operating expenses. (See the summary of our argument on this point in the printed oral argument, page 14, ff.) The Court does not mention our discussion of this question.

In the *Fano* case, this Court adopts in effect the principles announced in *Case v. Los Angeles Lumber Products Co.,* 308 U. S. 106, as applicable in proceedings under the Municipal Bankruptcy sections. This, of course, is, we contend, quite correct. In the *Merced* case, however, this Court wholly ignores and in substance repudiates the doctrines there announced, namely, that:

> (a) A debtor whose assets exceed its liabilities may not scale down its debts against unsecured creditors, to say nothing of secured creditors;

(b) A debtor cannot submit a plan as fair which rests upon the proposition that no plan at all would have been worse. In the *Merced* case the Court in substance holds the precise contrary in the part of its opinion wherein it traces the history of the District and quotes the trial court's opinion, both emphasizing and relying on the argument that if no plan had been adopted the District would probably have been unable to pay as much as it now offers. (Opinion, pp. 44-46)

(5) We have devoted much time in the past to the District's power revenue, and have demonstrated, we believed, that the District's power revenue alone, without the levy of any assessments whatever, will pay off completely the refunding bond issue proposed in this proceeding, and that after those bonds have been paid the District will (having accumulated a capital depreciation fund) have in effect a new power plant, paid for with the bondholders' money, and will thereafter be able to operate without any assessments whatsoever, even for operating expenses. This Court's only mention of power revenue is contained in its treatment of insolvency where the Court states:

> "The claimed fact that power revenues, etc. of the District will be sufficient to meet the obligations after they have been scaled down as proposed by the plan, does not have any bearing on the question of insolvency of the District."

Assuming that the proposition just quoted is correct, it wholly ignores, as does the Court's opinion as a

whole, the vital importance of power revenue as bearing on the District's ability to pay, i.e., as bearing on the question whether the plan is fair.

IV.

CLASSIFICATION OF CLAIMS

The Court ignores the fact that the RFC is a secured creditor, and that under the provisions of the Bankruptcy Act, Section 83(b):

> "The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute *a separate class or classes of creditors.*"

The RFC contract provides that the RFC shall not be obligated to make the loan

> "unless the Borrower shall provide for the allocation of funds and income derived from the sale of electrical power by the Borrower to the payment of the loan authorized by this Resolution in an amount and manner satisfactory to the Division Chief and Counsel." (Ex. 00, pp. 177-8)

And the final refunding bond purchase contract (Ex. 00, p. 202) provides for the allocation of power revenue to the maintenance of a reserve fund, and to the ultimate payment of the refunding bonds. (Ex. 00, pp. 208-210) This reserve fund now contains over $1,000,000. (R. 669)

No amount of refined logic can obscure the fact that the debt owing to the RFC, whatever its amount and however it be evidenced, is secured by a very large amount, and has been so secured ever since it became a creditor in any imaginable sense. And under the inescapably plain language of the statute, such a creditor (even assuming it is otherwise in the same class with us), must be classified in a different class from creditors who, like the objecting bondholders, are not similarly secured.

In short the RFC has, in this particular case, voluntarily contracted itself into a different class of creditors from the objecting bondholders.

V.

GOOD FAITH OF THE DISTRICT

We shall not discuss this point at length. We respectfully submit, however, that even assuming with the Court that the District misappropriated only $320,000 instead of $717,000, as we contend, that fact, and the fact that the part of this sum to which the dissenting bondholders are entitled is "comparatively small" cannot gloss over the gross fact that the District misappropriated nearly one-third of a million dollars which, as the Court assumes, was "in the face of the bondholders' rights."

The Court characterizes several items of misrepresentation in the statements, submitted to the Court by the District to show that it needed relief, as mere

"bookkeeping items." Most fraudulent misrepresentations of financial condition are.

The Court seems to admit (at any rate it assumes) that in stating its total net worth, the District set up nearly a million dollars as operating expenses which should have been set up as capital assets. The effect indisputably was that the District's total net worth was represented to the Court by the District as nearly one million dollars less than it is in fact. We submit that the Court's treatment of this item does not dispose of the fact that this was a gross misrepresentation of the true condition of the District, put forward by the District as demonstrating that the plan was fair.

VI.

IS RECONSTRUCTION FINANCE CORPORATION A CREDITOR AFFECTED BY THE PLAN?

We point out the following:

(1) In discussing this question the Court ignores a vital provision in the contract between the RFC and the District. Immediately after the provision, which the Court deems important, whereby the RFC reserves the right "to enforce * * * full payment of principal and interest of such Old Securities", *and in the same sentence,* appears the following (Ex. OO, p. 165):

> "if the Borrower shall, before any New Bonds are delivered to this Corporation, pay or cause

> to be paid to this Corporation an amount equal to the disbursements it has made to or for the benefit of the Borrower with 4% interest thereon until paid, this Corporation will thereupon surrender or cause to be surrendered the Old Securities then held by it or on its behalf to the Borrower."

To say that the RFC is the absolute owner of the bonds which it is thus bound to surrender upon receiving 50 per cent of their face value, or to say that it is affected just as we are, by the plan which gives it precisely the same amount as it is bound in any event to accept, is, we submit, not reasonable.

Three conclusions follow: (a) The District does not owe the full amount of the bonds, (b) the RFC is in a class of creditors distinct from the class of which objecting bondholders are members, and (c) RFC is not a creditor affected by the plan.

(2) The Court ignores the many cases cited in the separate brief of Florence Moore, et al., (pp. 29-32) and in appellant's reply brief, (pp. 13-17) which show, we submit, that the provisions of the statute upon which the Court relies should not be construed as making the RFC a creditor for the full amount of the bonds.

(3) The Court seems wholly to ignore our analysis of *Luerhmann v. Drainage Dist. No. 7,* 104 F. (2d), 696, which shows, we submit, that the *Luerhmann* case has no bearing here. (Appellant's Reply Brief, pp. 23-25)

(4) In reply to our argument that subdivision (j) of Section 403 of the Act is not applicable here because not intended to operate retrospectively, this Court says that our argument is "premised upon the assumption that the Old Bonds were extinguished before the section was enacted." Such was not our argument. Preliminarily the Court's invocation of subdivision (j) assumes that but for that provision the RFC's rights under its contract would be those of a pledgee, limited to the amount of its loan. This because unless the Court's argument so assumes there is no purpose in invoking subdivision (j). To apply subdivision (j) here would be to make it say in substance that whereas the RFC took over bonds some years before the enactment of this statute, and whereas by the contract the RFC's rights in the bonds were those of a pledgee to secure a debt of approximately one-half the face value thereof, it is hereby enacted that the debt thus created is doubled (as against other creditors), and the RFC's rights as a pledgee are, as against them, converted into those of an absolute owner.

(5) The Court ignores the simple fact that subdivision (j) above discussed, upon which the Court relies as entitling the RFC to consent to the plan, was not enacted until after this proceeding had been commenced and could not, therefore, possibly support the purported consent of the RFC.

(6) The Court ignores the fact that the provisions of the statute upon which it relies as validating the

consent of the RFC do not suggest that they were intended to enact that the debtor is to be deemed to owe the entire face value of the bonds held by the RFC *in determining whether or not the District is insolvent, or in determining whether or not the plan is fair.*

CONCLUSION

We submit that the considerations above discussed, together with the considerations heretofore urged by appellants re-examined in the light of the foregoing, call for a rehearing of this appeal, and for reversal of the judgment of the Court below with directions to dismiss the proceeding.

Respectfully submitted,

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San Francisco, October 3, 1940.

Certificate of Counsel

We hereby certify that in our judgment the foregoing Petition for Rehearing is well founded and that it is not interposed for delay.

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Attorney for Appellants, Milo W. Bekins and Reed J. Bekins as trustees appointed by the Will of Martin Bekins, deceased; Milo W. Bekins and Reed J. Bekins as trustees appointed by the Will of Katherine Bekins, deceased; Reed J. Bekins; Cooley Butler; Chas. D. Bates; Lucretia B. Bates; Edna Bicknell Bagg; Nancy Bagg Eastman; Charles C. Bagg; Horace B. Cates; Barker T. Cates; Mary Edna Cates Rose; Mildred C. Stephens; N. O. Bowman; W. H. Heller; Fannie M. Dole; James Irvine; J. C. Titus; Sam J. Eva; William F. Booth Jr.; George N. Keyston; George W. Pracy; H. T. Harper, and George B. Miller as trustees of Cogswell Polytechnical College; Tulocay Cemetery Association, a corporation; Percy Griffin; Emogene Cowles Griffin; D. Lyle Ghirardelli; A. M. Kidd; Grayson Dutton; Stephen H. Chapman; Edith O. Evans; J. Ofelth; Dante Muscio; I. M. Green; E. J. Greenhood; Julia Sunderland; Lily Sunderland; Florence S. Ray; Joseph S. Ray; Amelia Kingsbaker; S. Lachman Company, a corporation; Sue Lachman; Sophia Mackenzie; Nettie Mackenzie; R. J. McMullen; J. R. Mason; Gilbert Moody; William Payne; C. H. Pearsall; Sherman Stevens; Margaret B. Thomas; Isabella Gillett and Effie Gillett Newton as executrices of the Estate of J. N. Gillett, deceased; Theo. F. Theime; Fletcher G. Flaherty; Frances V. Wheeler; Miriam H. Parker; Apphia Vance Morgan; First National Bank of Pomona; George F. Covell; Alma H. Moore; George Habenicht; Seth R. Talcott; Adolph Aspergren; J. H. Fine; Mrs. J. H. Fine; F. G. G. Harper; and W. S. Jewell.

HERMAN PHLEGER,
BROBECK, PHLEGER &
HARRISON,

Attorneys for Appellants, Florence Moore; American Trust Company, as trustee under a certain agreement between R. S. Moore and American Trust Company dated December 15, 1927; Crocker First National Bank, as trustee under a certain agreement between Florence Moore and Crocker First Federal Trust Company, dated December 15, 1937.

San Francisco, October 3, 1940.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District and Reconstruction Finance Corporation,

Appellees.

PETITION OF APPELLANT, MINNIE RIGBY, ET AL., FOR A REHEARING.

Peter tum Suden,

605 Market Street, San Francisco,

Attorney for Appellant and Petitioner, Minnie Rigby, et al.

Pernau-Walsh Printing Co., San Francisco

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No. 9242

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Appellees.

PETITION OF APPELLANT, MINNIE RIGBY, ET AL., FOR A REHEARING.

To the Honorable Curtis D. Wilbur, Presiding Judge, and to the Associate Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Minnie Rigby and Richard tum Suden, as executrix and executor of the estate of William L. Lieber, deceased, respectfully petition this Honorable Court to grant a rehearing in the above entitled action, and in that behalf urge:

I.

CONSENT OF HOLDERS OF CALIFORNIA IRRIGATION DISTRICT BONDS CANNOT CONFER JURISDICTION ON CONGRESS TO EXTEND THE BANKRUPTCY POWER TO SUCH DISTRICTS WHICH ARE EXCLUSIVELY GOVERNMENTAL AGENCIES.

This Court has made a decision which is wholly and patently erroneous because of the Court's failure to perceive the precise nature of a California irrigation district under the California Irrigation District Act, particularly as more clearly defined by the State Courts of last resort in California since the decision of the United States Supreme Court in *U. S. v. Bekins,* 304 U. S. 27, 82 L. ed. 751, in April, 1938, construing Secs. 81 to 84 as added to the Bankruptcy Act by the act of August 16, 1937.

Every irrigation district in this State exists and functions wholly and solely in a governmental capacity "only for governmental purposes" as a "political subdivision" of the State. No irrigation district in this State acts in any proprietary capacity; no district holds or owns any property in a proprietary capacity.

> *El Camino Irr. Dist. v. El Camino Land Corp.* (Nov. 1938) 12 Cal. (2d) 378, 383; 85 Pac. (2d) 123, 125.

In this respect a California irrigation district differs from districts organized under the laws of many other states, and from a municipal corporation, but falls within "political subdivisions" as mentioned in Sec. 80 of the first municipal debt relief act of May 24, 1934.

The sovereignty of the State of California precludes any exercise of the federal bankruptcy power over the State itself or over any political subdivision of the State which has exclusively governmental capacity and exercises exclusively governmental functions, with no proprietary capacity or functions. Without the State's consent any attempt of Congress to exercise such a power would certainly be an interference with the State's power of taxation.

But if Congress is devoid of such power without consent of the sovereign State, the State cannot give its consent, for to do so would be a surrender of one of its sovereign functions, viz., the power of taxation exercisable through one of its governmental agencies. It would be an abnegation of the State's sovereignty.

When the Constitution of this country was set up, was ratified, we created a **unique** system of government, which has never existed anywhere else in the world. We created **two** sovereignties, operating in the same territory. The States were sovereign States, before the ratification of the Constitution. The Supreme Court of the United States has ruled that they achieved their sovereignty on July 4, 1776, and their first attempt at organization was under the Articles of Confederation, in the second article of which each State expressly reserved its sovereignty and declared it was not delegating it to the central government.

65 *C. J.* 1254, 1265.

They did not delegate that sovereignty to the United States, when the Constitution was ratified, and it

was necessary to delegate to the United States a **certain degree** of sovereignty, but they created a government **purely of delegated** powers, and to make it certain that they had not delegated all of their sovereignty to the United States Government the tenth amendment was ratified which expressly declares that all powers not **expressly** delegated to the United States are **reserved** to the States or to the people.

Now, that system of **two sovereignties** operating in the same territory is what brings about the very problem that we are now discussing. When you have two sovereignties operating in the same territory, a certain degree of friction is inevitable, and these doctrines of immunity from taxation or interference of one sovereignty by the other, are simply a series of compromises which were necessary in order to make that mechanism work with as little friction as possible, because if one sovereign could tax the other or **interfere** with its **taxing power** it could legislate **it out of existence.**

> "One branch of the Government cannot encroach on the domain of another without danger. The safety of our institutions depends in no small degree on a strict observance of this salutary rule."
>
> Sinking Fund cases, 99 U. S. 700 at 718.

Furthermore, whatever power the Congress has over bankruptcy it has such power without the "consent" of a particular state in a particular proceeding, and irrespective of the state's giving or withholding

"consent" to federal jurisdiction. "Consent" does not confer jurisdiction of any particular proceeding.

In

Ashton v. Cameron County, etc., District (1936) 298 U. S. 513, 56 S. Ct. 892,

the Court said:

> "Neither consent nor submission by the states can enlarge the power of Congress; none can exist except those which are granted."

It should be observed, also, that Sec. 80 of the Bankruptcy Act, added in 1934, the first municipal bankruptcy act, which was held unconstitutional in

Ashton v. Cameron County, etc., Dist. (1936) 298 U. S. 513.

specifically purported to be applicable to "any municipality or other **political** subdivision of any state."

Sec. 81, enacted August 16, 1937, gives courts of bankruptcy original jurisdiction "for the composition of indebtedness of, or authorized by, any taxing agencies or municipalities hereinafter named", to-wit: Certain agricultural improvement districts or local improvement districts organized for agricultural purposes, etc. The avoidance of the term "political subdivision of any state" indicates an intention of Congress to obviate the unconstitutional aspect of the former act and a determination to give the bankruptcy courts no jurisdiction over "political subdivisions" whose functions are solely and exclusively **governmental.**

The significance of this change in terminology is increased by the enactment in the later amendment

of Sec. 81 of a clause to permit a separate operation of the act in respect to certain kinds of districts, etc., e. g., those having proprietary powers and functions, if such application of the amendment would save its constitutionality at least in part.

The proviso at the end of Sec. 81 of the Act, as amended August 16, 1937, is as follows:

> "Provided, however, that if any provision of this chapter, on the application thereof to any **such taxing agency or district or class thereof** or to any circumstance, is held invalid, the remainder of the chapter, or the application of such provision to any other **or different taxing agency or or district or class thereof** or to any other or different circumstances, shall not be affected by such holding." (The new matter is indicated by our emphasis.)

The constitutionality of the several Revenue Acts enacted by Congress to raise federal income taxes has been frequently sustained by the Courts; each of these acts empowers Congress to tax income from "whatever source derived." Yet the Courts have never ruled that Congress has the power to tax interest from bonds issued under the California Irrigation District Act, irrespective of whether consent of some bondholders was or was not given, and irrespective of any consent by any state to a levy of a federal income tax on interest on bonds issued by its irrigation districts.

It is interesting to note that when the U. S. Commissioner of Internal Revenue attempted to tax the

salary of the secretary of a California irrigation district, counsel who in the case at bar assert the applicability of the bankruptcy statute to California irrigation districts vigorously opposed the applicability of the revenue act.

In

Baldwin v. Commissioner, B. T. A. Docket No. 86065, Decision June 2, 1939,

the United States Board of Tax Appeals, in upholding the correctness of such objections, held:

> "Counsel for petitioners have filed able and exhaustive briefs to support the contention that an irrigation district in the State of California is a public agency of the State performing essential governmental functions. The findings of fact have been made in some detail, as far as is deemed necessary. Upon the facts and the local law cited, we conclude that the Nevada Irrigation District is a public agency and political subdivision of the State of California, exercising functions defined by statute and authorized by the Constitution of the State of California which are **essentially governmental** as opposed to proprietary. It is well known that irrigation of arid lands is a matter involving the general welfare in California and the Supreme Court of California, upon such consideration of the subject, has concluded that the use of water for irrigation is a public use and that irrigation districts, created under a constitutional irrigation act, are public agencies of the State whose functions are **exclusively** governmental. We have ample authority for concluding as we have done above and refer to decisions by name only, believing it unnecessary to discuss the cases.

> Fallbrook Irr. Dist. v. Bradley, 164 U. S. 112; El Camino Irr. Dist. v. El Camino Land Corp., 85 Pac. (2d) 123, 125; Anderson-Cottonwood Irr. Dist. v. Klukkert, 97 Cal. Dec. 348, 352; Moody v. Provident Irr. Dist., 85 Pac. (2d) 128, 130; in the matter of the bonds of Madera Irr. Dist., 92 Cal. 296; 28 Pac. 272, 275. On the limited question of whether Nevada Irrigation District's function of impounding and distributing water for irrigation is an exercise of an **essential governmental function,** the case, Brush v. Comm., 300 U. S. 352, is applicable here * * *." (Emphasis supplied.)

If Chapter IX of the Bankruptcy Act were a taxing act instead of a bankruptcy act, no one would contend that the consent of holders of California Irrigation District bonds to pay a federal income tax on interest would create any power in Congress to exact such revenue. If consent of bondholders would not give Congress any power not already possessed to enact a federal tax law, it must follow that "consent" of the State or of any holders of California Irrigation District bonds would not create the power for Congress to apply any provision of the Bankruptcy Act to this district. Congress either has the power without the consent of the bondholders or the "consent" of bondholders is a futile attempt to confer such power upon Congress.

When the State acting through an Irrigation District issued these bonds, the State irrevocably empowered its agent, the Irrigation District, to contract with the purchasers of the bonds that the State itself would never, directly or indirectly, give a consent

to an impairment of the agency's right and duty to devote to the payment of the bonds the rental value, present and future, or usufruct, of the land within the district.

In

Louisiana v. Pilsbury (1882) 105 U. S. 278, 288; 26 L. ed. 1090,

this principle is stated in the following language:

> "The case of *Von Hoffman v. Quincy,* reported in 4th Wallace, 535 (71 U. S. XVIII., 4031), is a leading one on this subject. The Court there said: 'That when a State has authorized a municipal corporation to contract, and to exercise the power of local taxation to the extent necessary to meet its engagements, the power thus given cannot be withdrawn until the contract is satisfied. The State and the corporation, in such cases, are equally bound'."

In

Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365,

the Court was faced with a situation in principle similar to, if not identical with, that involved in the case before this Court. There, as here, the respondents contended that the Provident Irrigation District was insolvent because its bonds and coupons past due greatly exceeded the ability of the district to pay delinquencies from uncollected assessments. The district itself had acquired practically all of the land within its boundaries. The Court there said:

> "But laying aside quibbles as to the exact meaning of the phrase 'uses and purposes', it seems

clear that to function on borrowed money, repayment of the money is not a wholly immaterial and foreign objective. Evading creditors is not a contemplated activity of a public district, whose bonds are recognized investments for financial institutions. Among other purposes of the act, therefore is the repayment of the bondholders of the district, and it follows that this is one of the purposes of which the **trust money** is held.

This view is fortified by a consideration of the general plan of the statute, in so far as it provides for the creation of an obligation and a procedure for payment. The land is the ultimate and only source of payment of the bond. **It can never be permanently released from the obligation** of the bonds until they are paid. The release from liability for assessments while the district holds title is intended to be temporary only, and the liability for new assessments is again imposed when it goes back into private ownership. **Any practice** which removes the land as ultimate security for the bonds, or which places its proceeds beyond the reach of the bondholders, destroys that plan and is contrary to the spirit of the act. And the practice employed by the district herein does exactly that. Theoretically and formally the remedies of the bondholders remain unaltered. Actually they have been destroyed. Economic conditions have placed the land outside of the power of assessment for payment of the bonds. But it is the act of the directors alone which has taken the **proceeds** of the land from the bondholders. This use of the funds, contrary to the whole intent of the act, is in our opinion in violation of the **trust impressed on the land** under Section

> 29. * * * We assume, for the purposes of this case, that the directors, in their discretion, may determine that some of the proceeds of **leasing** of lands are essential to operation and maintenance, and may use them for these purposes. But any surplus, over and above operating expenses, **remains subject to the trust,** and should go to the payment of the bondholders." (Emphasis ours.)

Also on November 28, 1938, the California Supreme Court said in *Moody v. Provident Irr. Dist.,* 12 Cal. (2d) 389 at 395:

> "That the annual assessments and the sale of the lands upon which the assessments are not paid may never realize sufficient money to pay the indebtedness of the district is entirely beside the question. The property of the district, so far as it owns any property, constitutes **a public trust** and is held by the district for **a public use**, and, therefore, is **not subject** to levy and sale upon **execution** by a creditor of the district. (Citing cases.) That the **statute of limitations,** under the circumstances disclosed by this case, could **never** be pleaded by the district until it had the money in its possession to pay the bonds belonging to plaintiff, and had given notice, is supported by the case of Freehill v. Chamberlain, 65 Cal. 603, 4 Pac. 646 * * *." (Emphasis ours.)

To such an extent has this doctrine been carried that all property owned by the district is a "Public Trust" and beyond the reach of any other taxing agency of the State. The property of the district, as the agent of the State, is the property of the State.

Property of the State is exempt from taxation. Therefore, while property within the district, title to which is taken by the district for default in the payment of assessments, is held by the district as trustee for the "uses and purposes of the Act", the land itself and the district's share of crops in a warehouse are exempt from taxation.

Anderson-Cottonwood Irr. Dist. v. Klukkert, 13 Cal. (2d) 191;

Glenn-Colusa Irr. Dist. v. Ohrt, 31 Cal. App. (2d) 618.

To now hold that this "Public Trust" as determined in the late decisions, supra, and which is exempt from taxation or execution by any creditor, is subject to destruction by Congress, is to sanction repudiation without precedent, and to reverse the protection guaranteed by the countless tests of this California Statute, beginning with Fallbrook Irr. Dist. v. Bradley, 164 U. S. 112, and which decision has never been acceptable to the private ground rent collectors since Mr. George H. Maxwell argued in that historic case: "It (the Cal. Irr. Dist. Act) is communism and confiscation under the guise of law."

II.

THE RENTAL VALUE OF LANDS ACQUIRED BY THE DISTRICT ON TAX FORECLOSURE IS A PERPETUAL "PUBLIC TRUST" FOR THE USES AND PURPOSES OF THE ACT. CONGRESS CANNOT THROUGH THE BANKRUPTCY ACT EMPOWER ANY COURT TO IMPAIR OR REPUDIATE SUCH A PUBLIC TRUST. THIS WOULD CONSTITUTE AN UTTER DENIAL OF FAIRNESS TO APPELLANTS' RIGHTS.

The rental value of land pledged as security for money borrowed by such a district is equivalent to a first lien on all the property of the district.

To permit any portion of this rental value to accrue to private interests (as it would if bonds of the irrigation districts are scaled down) or to the State itself while lawful indebtedness is past due and unpaid is tantamount to allowing a second mortgage to be paid, while the first mortgage is ordered drastically scaled down. Such a procedure would be a clear violation of law as is shown in

Case v. L. A. Lumber Products (Jan. 1940) 307 U. S. 619, 84 L. ed 22.

California Irrigation District bonds have been uniformly held to constitute general obligations payable from unlimited annual taxes or assessments levied according to the value of the land (exclusive of improvements) and not in any sense according to "ability to pay"; when land is foreclosed by the District for unpaid assessments, the present and future rent of the land takes the place of taxes and assessments against land in private ownership.

Provident v. Zumwalt, 12 Cal. (2d) 365;

Cosman v. Chestnut, 238 Pac. 879;

Rialto v. Stowell Irr. Dist., 246 Fed. 294;
Farwell v. San Jacinto Irr. Dist., 49 Cal. App. 167;
Norris v. Montezuma, 248 Fed. 369;
George v. Braddock, 18 Atl. 881;
State v. Amana Society, 109 N. W. 894;
Fairhope Single Tax Colony v. Melville, 69 So. 466;
State v. Aiken, 284 N. W. 63;
In re Meador, 1 Abb. (U. S.) 334;
Osborne v. Mobile, 44 Ala. 499;
A. T. & S. F. Ry. Co. v. Elephant Butte Irr. Dist., 110 F. (2d) 767.

In

Roberts v. Richland Irr. Dist., 289 U. S. 71,

the United States Supreme Court ruled that the assessment may exceed the benefits. Such bonds must not be confused with ordinary assessment bonds which are secured only by specific and limited assessments that must be collected within a limited number of years or the land becomes subject to sale by the State for unpaid general taxes free and clear of the uncollected special assessments and also free and clear of any further obligation to pay such bonds.

It is not only the right, but the duty of a California county to keep land on its tax paying rolls, and any bond contracts of other taxing agencies that interfere should be assumed or compromised by county.

County of San Diego v. Hammond, 6 Cal. (2d) 709;

County of Los Angeles v. Jones, 92 Cal. Dec. at 120-121, paragraphs 9 and 10; 6 Cal. (2d) 695.

Therefore, the **real question** is not whether Congress exceeded its powers in enacting Sec. 81, but it is whether this act can be applied to such a political subdivision of the State as a California Irrigation District, which the **late** decisions of the California Supreme Court has so defined and determined it to be.

The power of Congress to pass an act affording the relief of bankruptcy to some taxing units, and the applicability of such act to State agencies having only **governmental** functions are two wholly different matters.

Surely, if Congress can enact a law under which these bonds can be repudiated, it must have an equal power to subject them to taxation, under the tax clause. To hold otherwise, would be to accord the bankruptcy clause a higher rank and dignity than the taxing clause, which the Ashton case appears to hold squarely cannot be done.

The Courts in all the 164 years of our National life have never implied that the taxing and borrowing power of the States is, under any clause in the Constitution subject to interference, or regulation through an Act of Congress, and such expressions as have been occasioned on the subject are unmistakably against the existence of such a power. If Congress has such power, with the consent of some bondholders, and one

State, it would unquestionably have the power without such consents. There is here involved a fundamental principle of Constitutional law that far transcends in importance of any debt problems of a State or its political subdivisions, or those of the holders of its securities.

With regard to the requirement that the plan be "fair and equitable" and the allegation on page 2 of brief of Amicus Curiae, Irrigation Districts Association of California, dated October 11, 1938, in No. 9206 in this Court:

> "This problem and its acuteness is not peculiar to California, but unfortunately is one of the major problems facing California today. A failure of solution will result in a **major catastrophe** in the State."

it will be noted that Amicus Curiae does not say, "A failure to get **approval of these petitions** will result in a major catastrophe", nor do they even hint the precise economic interests that would be losers.

> "It is an invitation of the most pronounced kind to covinous transactions, inevitably resulting in the release of property from just burdens of taxation by a sale thereof, in form only."
>
> *City of Beatrice v. Wright,* 101 N. W. 1041.

In

> *Monk Realty Corp. v. Wise Shoe Stores, Inc.*
> (1940) 111 F. (2d) 287, 290,

the Court has held:

"A landlord is entitled to insist that his lease be either rejected or fully assumed, under the plan."

Bankruptcy courts are without power to discharge future debts.

Zavelo v. Reeves, 227 U. S. 625.

Most of the bonds owned by appellants still have many years to run. None of the bonds are callable at any price, prior to maturity.

In *Happy Valley Water Co. v. Thornton,* 34 Pac. (2d) 991, the dissolution of a bonded California Irrigation District is discussed and the Court refers to the bonds as a debt of the **landholders** rather than as a debt of the Irrigation District. The District was merely an instrumentality of the State.

In

Provident Land Corp v. Zumwalt (1938) 12 Cal. (2d) 365, 376,

the court held that in cases where taxes produced insufficient money to meet the requirements of the district, the full rental value of land, present and future, if necessary, is one of the assets of the "Public Trust", created by the Legislature under this law, for the "uses and purposes of the Act".

ARE THE RIGHTS OF THE STATE TO THE RENTAL VALUE OF LAND, PLEDGED AS SECURITY FOR MONEY BORROWED BY ITS AGENCY ANY MORE SUBJECT TO CONTROL BY A COURT OF BANKRUPTCY THAN RENT PROMISED TO A PRIVATE LANDLORD? DO OUR COURTS UPHOLD

THE DOCTRINE THAT IT IS ILLEGAL FOR A BANKRUPTCY COURT TO REQUIRE THAT A PRIVATE LANDLORD CONTINUE A LEASE IN EFFECT BUT AT A RENT LESS THAN THAT STIPULATED IN THE CONTRACT, BUT LEGAL FOR SUCH A COURT TO COMPEL HOLDERS OF THESE BONDS OF A POLITICAL SUBDIVISION OF THIS STATE TO SURRENDER ALL OR A PART OF THEIR RIGHT TO THE USUFRUCT OR RENTAL VALUE OF LANDS OF SUCH DISTRICT IN REPUDIATION OR VIOLATION OF THE DISTRICT'S IRREVOCABLE CONTRACT WITH THEM TO CONTINUE TO COLLECT SUCH GROUND RENTS UNTIL ALL BONDS HAVE BEEN FULLY PAID?

In more than one California Irrigation District, the irrigation district law, when permitted to operate as enacted by the State, has eliminated all former mortgages and other private liens through foreclosure of tax liens, yet the districts, as such, have in no instance "collapsed". The orderly operation of this law has, in such instances, worked to free the land from impossible private debts and obligations, and to make it accessible to home, farm and orchard seekers, who are now enabled to rent or buy the land direct from the Irrigation District, on terms no more onerous at the worst than were formerly demanded as rent when the land was held under private ownership. If any land in the district is without a rental value, present or future, no scale-down of the district debt will create a rental value for that or any other land in the district. **THIS RENTAL VALUE OF THE LAND**

(which the California Supreme Court in *Provident Land Corp. v. Zumwalt* (12 Cal. (2d) 365) decreed to be the real and ultimate revenue source which the Legislature of California has pledged as a "Public Trust" to its agent, the Irrigation District, for its necessary operation and maintenance expenses and payment of lawfully incurred public indebtedness) **CANNOT LESSEN THE REWARD OF INDUSTRY, NO MATTER WHO COLLECTS IT, NOR ADD TO OR DECREASE CROP PRICES, NOR IN ANY WAY TAKE FROM THE INDIVIDUAL, AS USER, WHAT BELONGS TO THE INDIVIDUAL WHO HAS PAID LAWFULLY DUE TAXES, WHETHER PAID AS TAXES OR AS RENT TO THE DISTRICT AS A STATE AGENCY OR TO A PRIVATE LANDLORD.**

In the Constitution of California, Art. XVII, Sec. 2, is found:

> "The holding of large tracts of land, uncultivated and unimproved by individuals or corporations, is against the public interest, and should be discouraged by all means not inconsistent with the rights of private property."
>
> *Fulton v. Brannan,* 88 Cal. 454.

The Governor's Commission on Re-employment, after careful studies, made its report September 30, 1939. In Chapter VII is the following:

> "Settlement and resettlement programs are largely dependent upon the availability of low cost lands, as well as the economical utilization of tax-delinquent property which has been deeded or

> sold to the State. * * * The situation with regard to tax delinquent property is particularly in need of study and clarification. * * * No accurate figures are available but certain studies have revealed that at least 2,000,000 acres of rural land and 40,000 acres in subdivided urban lots are held by the State under tax deeds. Rural tax delinquency reached a peak in 1932 when more than 8,500,000 acres, 17% of California's farm land, were burdened with unpaid taxes. * * * A conspicuous feature of agriculture in California is large scale ownership and operation of farm land. **The most casual survey reveals that thousands of families with farm experience are unable to buy or rent land.** At the same time, large scale farming is more prevalent in California than in any other State. * * * All the problems centering in the **ownership** and **use** of land are so vital to the larger aspects of the employment and living conditions of our citizens that a **thorough overhauling of our land policies,** including records, **taxes, delinquency laws,** penalties and ownership should be made."

The California State Planning Board in its 1938 report entitled "Tax Delinquent Land in California" vigorously recommended that, tillable tax forfeited and tax foreclosed land "be made available for resettling homeless 'dust bowl' and other families now in California".

As for the "rental value of land" within a California Irrigation District, it matters not at all whether that value, present or future, be much or little. **Whatever** it is, or may become, it is the exclusive property of the Irrigation District, (Provident Land Corp. v.

Zumwalt (supra)) and is in effect **dedicated** as part of the "Public Trust" **to any degree or extent** necessary to meet costs of operation and debts of the district. If the land has no rental value, the bonds will never be paid and no bondholder would be allowed to sue the State, which endorsed the bonds, without its consent. Under these decisions, no user of land can be compelled to pay more than the actual economic rent, i. e., no more than he would have to pay a private landlord for similar land. Whether such rent is paid to a private landlord or to a state agency matters not to a user of land. It is only as private interests are enabled to appropriate the ground rent which they believe they can charge users of the land, that land acquires a so-called "market value". The only effect of denying the petition of the district for relief under Chapter IX will be to keep land prices from rising as high as they otherwise would. California Irrigation Districts have better rights to the rent from their land than any private interest, and the "disaster" from failure to scale down all the bonds would be primarily to private interests, who will be otherwise enabled to collect more land rent for themselves, after taxes. Courts of equity usually accord public contracts even stronger protection than private contracts.

Excerpt from letter of Lincoln to his law partner Gridley.

"The land, the earth that God gave to man for his home, sustenance and support, should never be in the possession of any man, corporation, society, or unfriendly government, any more than air or

water, if as much. An individual, or company, or enterprise requiring land should hold no more than is required for their home and sustenance, and never more than they have in actual use in the prudent management of their legitimate business, and this much should not be permitted when it creates an exclusive monopoly. All that is not so used should be held for the free use of every family to make homesteads, and to hold them as long as they are so occupied."

"A reform like this will be worked out sometime in the future. The idle talk of foolish men, that is so common now, on 'Abolitionists, agitators, and disturbers of the peace', will find its way against it, with whatever force it may possess, and as strongly promoted and carried on as it can be by land monopolists, grasping landlords, and the titled and untitled senseless enemies of mankind everywhere."

"Abraham Lincoln. The men of his time." Vol. II, pages 89, 90, by Robert H. Browne, Blakely-Oswald Printing Co., Chicago.

"Both ground rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the State, no discouragement will thereby be given to any sort of industry. The annual produce of the land and labor of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground rents and the ordinary rent of land are, therefore, perhaps the species

of revenue which can best bear to have a peculiar tax imposed upon them.

"Ground rents seem, in this respect, a more proper subject of peculiar taxation than even the ordinary rent of land. The ordinary rent of land is, in many cases, owing partly at least to the attention and good management of the landlord. A very heavy tax might discourage too much this good attention and management. Ground rents, so far as they exceed the ordinary rent of land, are altogether owing to the good government of the sovereign, which by the protecting industry either of the whole people or the inhabitants of some particular place, enables them to pay so much more than its real value for the ground which they build their houses upon; or make to its owner so much more than compensation for the loss which he might sustain by this use of it. Nothing can be more reasonable than that a fund which owes its existence to the good government of the State should be taxed peculiarly, or should contribute something more than the greater part of other funds toward the support of the government."

Adam Smith, "Wealth of Nations," Book V, Chap. 2, Part 2, Art. 7.

"Meanwhile, we shall do well to recollect, that there are others besides the landed class to be considered. **In our tender regard for the vested interests of the few, let us not forget that the rights of the many** are in abeyance, and must remain so, as long as the earth is monopolized by individuals. Let us remember, too, that the injustice thus inflicted on the mass of mankind, is an injustice of

the gravest nature. **The fact that it is not so regarded, proves nothing.** In early stages of civilization even homicide is thought lightly of. * * * It was once also universally supposed that slavery was a natural and quite legitimate institution—a condition into which some were born, and to which they ought to submit as to a Divine ordination; nay, indeed, a great proportion of mankind hold this opinion still. * * * We find that if pushed to its ultimate consequences, a claim to exclusive possession of the soil involves **a landowning despotism.** We further find that **such a claim is constantly denied by the enactments of our legislature.** And we find lastly, that the theory of coheirship of all men to the soil is **consistent with the highest civilization**; and that, **however difficult** it may be to embody that theory in fact, **Equity sternly commands it to be done.**" (Emphasis ours.)

"Social Statics" (1851 Ed.), by Herbert Spencer, Chapter IX.

"A tax on rent falls wholly on the landlord. There are no means by which he can shift the burden upon anyone else. It does not affect the value or price of agricultural produce, for this is determined by the cost of production in the most unfavorable circumstances, and in those circumstances, as we have so often demonstrated, no rent is paid. A tax on rent, therefore, has no effect other than its obvious one. It merely takes so much from the landlord and transfers it to the state."

John Stuart Mill: *Principles of Political Economy,* Book 5, Chapter III, Sec. 2.

Abandonment of the doctrine of immunity, last reaffirmed in *Brush v. Commissioner,* 300 U. S. 352, must inevitably open the way for unlimited control by the Federal Government of the States and their local governments, for out of bankruptcy springs the mechanism of total domination by Congress of the States.

The real test of whether approval of this petition is "fair and equitable", not only to appellants, but the common good, might be decided by determining, "Will it promote opportunity for homes and employment? Will it make access to land easier? Will it make irrigated land cheaper?"

We submit in the light of the foregoing and the more recent decisions of the California State Supreme Court that the proceedings inaugurated by the District under Chapter IX, violate the provisions of Sec. 83, Par. "I" which reads as follows:

> "Nothing contained in this chapter shall be construed to limit or impair the power of the state to control by legislation or otherwise, any municipality or any political subdivision of or in such state in the exercise of its political or governmental powers including expenditures therefor."

And we submit further that the decree and order of the District Court interferes with the governmental and political powers of the petitioner as well as the property and revenues of the petitioner necessary for essential government purposes. (Sec. 83, concluding paragraph sub-section "c".)

Without repetition here of points and authorities submitted by other appellants in their several petitions for a rehearing in this and the related cases, we adopt such points and authorities as additional grounds in support of this petition and respectfully request a rehearing of this case.

Dated, San Francisco,
October 4, 1940.

Respectfully submitted,
PETER TUM SUDEN,
Attorney for Appellant and Petitioner,
Minnie Rigby, et al.

CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for appellant and petitioner, Minnie Rigby, et al., in the above-entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco,
October 4, 1940.

PETER TUM SUDEN,
Counsel for Appellant and Petitioner,
Minnie Rigby, et al.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

3

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District ~~and Reconstruction Finance Corporation~~,

Appellees.

BRIEF FOR APPELLANTS.

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No. 9242

IN THE

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BRIEF FOR APPELLANTS.

STATEMENT REGARDING JURISDICTION.

The District Court.

This proceeding was commenced by the filing of a petition (R. 8) for composition of debts under the provisions of Chapter 9 of the Bankruptcy Act of 1898 as amended (11 U. S. C. §§401-404), said petition being filed by Merced Irrigation District, an irrigation district organized under the provisions of "the California Irrigation District Act" of the State of California, approved March 31, 1897, and acts amendatory thereof. Appellants, holders of bonds of said district, appeared and filed their claims, answers and objections to the proposed plan. (R. 107.)

The Circuit Court of Appeals.

After a hearing of said petition the District Court entered a decree on February 21, 1939, pursuant to Section 83 of the Bankruptcy Act as amended, which decree confirmed the plan of composition proposed by said district. Notice of entry of said decree was mailed on February 28, 1939. Motion for a new trial was made by appellants on March 20, 1939 (R. 266), which was denied by the Court on March 28, 1939. (R. 267.) Appellants filed notice of appeal on March 29, 1939 (R. 268), copies of which notice were mailed to appellees by the Clerk of the Court on March 30, 1939. (R. 273.) On March 30, 1939 (R. 268), appellants filed a petition for an order allowing appeal (R. 274), with assignments of errors (R. 281), and on said day the Court made its order allowing the appeal (R. 280), and on said day the citation on appeal was made (R. 4), which citation was served on Merced Irrigation District on April 5, 1939 (R. 6), and on Reconstruction Finance Corporation on April 25, 1939. (R. 7.) The jurisdiction of this Court to entertain said appeal is the following: Sections 24, 25 and 83 of said Bankruptcy Act.

STATEMENT OF THE CASE.

The Merced Irrigation District is an irrigation district organized in 1919 under the provisions of the California Irrigation District Act, having a gross area of over 189,000 acres, and is situated in the County of Merced, in the Southern District of California, occupying the main portion of Merced County south of the Merced River and east of the San Joaquin River. It is the fifth largest irrigation district in the State. There are three incorporated cities within the boundaries of the district, the principal one of which is Merced, with a population of close to 10,000.

Prior to the organization of the district, irrigation was scattered over an area of more than 100,000 acres, although all of that area was not receiving water. The Crocker-Huffman Canal irrigated a maximum of 40,000 acres, and there was a large number of private pumping plants.

The Engineer's report in January, 1921, called for a total expenditure, with complete development, of $15,850,000. The estimated capitalized value of the energy to be produced at the power house was $6,932,000, leaving an estimated average net irrigation costs against lands in the district of $46.93 per acre. Under the plan the Crocker-Huffman system was purchased at a cost of $2,250,000; Exchequer Dam was built at a cost of $4,448,000 and the power plant at $2,000,000. Funds were allocated to improve and extend the distribution system and complete the drainage system and for the relocation of the Yosemite Valley railroad to take it out of the proposed Exchequer Reservoir site. Three small drainage districts were taken over, and their bonds assumed by petitioner. Agreements were made with respect to water rights for land along Merced River. Agreements were also made with holders of water rights under the Crocker-Huffman system. Neither the Crocker-Huffman contracts nor the bonds against the drainage districts were included in the composition plan and they are to be paid out in full. (R. 514.) When the work was done the bonded debt of the district came to $16,250,000. A more detailed history of the district will be found at page 118 of Respondents Exhibit OO.

Exhibit OO is the transcript of record in the Supreme Court of the United States, on the present petitioner's petition for certiorari in the prior proceeding brought to enforce the plan of composition here in question. Four printed copies of Exhibit OO are on file with the Court in the present record.

The bond issues of the district embraced within the composition proceeding consist of three issues of bonds aggregating $16,190,000 in principal amount, consisting of a first issue of $11,940,000 dated January 1, 1922, due serially from 1934 to 1962, bearing interest, part at 5½% and part at 6%; a second issue of bonds dated May 1, 1924, in the principal amount of $3,250,000 bearing interest at 6%, due serially from 1937 to 1964, and a third issue of bonds dated April 1, 1926, bearing interest at 5½% due serially from 1965 to 1966. (R. 10.)

The interest is represented by coupons payable to bearer and due semi-anually. These coupons and the matured bonds bear interest at 7% per annum under the provisions of Section 52 of the California Irrigation District Act when presented for payment and unpaid.

The Merced Irrigation District made all payments according to the maturities of its bond issues including principal and interest up to and including the payment due January 1, 1933. It defaulted on the July 1, 1933, payment.

At about this time an action was commenced in the Third District Court of Appeal in the State of California, entitled *Bates v. McHenry,* an action for writ of mandate against the treasurer of the district to require payment in the order of presentation under Section 52 of the California Irrigation District Act. The decision of this case appears at 123 Cal. App. 81, 10 Pac. (2d) 1038, and held that although the bond fund was then insufficient to pay all claimants in full payment must be made in the order of presentation until the fund was exhausted. This judgment is final.

Assuming that all bonds and coupons which have matured, commencing with July 1, 1933, under the foregoing bond issues, are outstanding and unpaid, the total amount of principal matured as of November 1, 1938, was $386,000

and the total amount of principal and interest claimed by petitioner to be past due was $6,468,072. (R. 669.) As we later show, this is an overstatement of the amount past due by more than one million dollars, even assuming that all of the bonds held by the R. F. C. are payable in full with interest.

One of the vital facts in the case is that long prior to the filing of the petition herein, and in fact prior to the enactment of the statute under which this proceeding was filed (Secs. 81-84 of the Bankruptcy Act), over 90% of the entire bonded debt had been surrendered by the bondholders for 51.501 cents on the dollar, the necessary funds having been loaned to the district by the R. F. C. Appellants rely strongly on the contention (a) that the petitioner's total indebtedness was thus reduced by more than $7,100,000 plus all overdue interest on the bonds taken up with funds lent by the R. F. C. (b) Since all this occurred long prior to the enactment of the statute in question, it obviously was not done with a view to the present proceeding or pursuant to the statute at all; and (c) it was therefore improper for the district to contend and for the court below to hold that the fairness of the plan should be determined on the theory that the district still owed the entire amount of principal ($14,686,000).

In March, 1932, a committee of representatives of the Houses that underwrote the Merced bonds joined with another association called the California Irrigation and Reclamation District Bondholders Association to form a committee (R. 495), and thereafter functioned as a Bondholders' Committee, of which B. P. Lester was Secretary. The Committee solicited the deposit of bonds under a deposit agreement dated March 1, 1932 (R. 576), and a major portion of the bonds, including those of many of appellants here, were deposited with the Committee. As

a result of various studies and negotiations a refunding program was submitted by the Board of Directors to the people of the district. This refunding program was voted upon favorably by the electors on November 22, 1933, and provided for payment in full of the bond principal of the district with an extension of maturities and some reduction in interest. (Ex OO, p. 91.)

After the enactment of Section 36 of the Emergency Farm Mortgage Act providing for loans by the R. F. C. to irrigation districts to reduce their debts, an application was made on December 16, 1933 (R. 600) by the district to the R. F. C. (The Reconstruction Finance Corporation is referred to throughout these proceedings as the R. F. C.)

The R. F. C. on November 14, 1934, granted a loan of $8,600,000 (Ex. OO, p. 155), and the offer of this loan was accepted by the district by a resolution dated December 11, 1934. (Ex. OO, p. 180.) This loan was calculated to pay 51.501 cents on the dollar of bond principal, with nothing for accrued interest and was word for word identical with the plan now sought to be enforced. (Ex. OO, p. 180.) This proposal was submitted to the California Districts Securities Commission which, by its Order No. 54 on February 15, 1935 (R. 949), approved the issuance of the refunding bonds and the making of the contract therefor. Thereupon the proposal was submitted to the electors who on March 20, 1935, voted in favor thereof. (R. 603.) The Bank of America owned over $3,000,000 of the bonds, principal amount. (R. 885, 504, 508.) This bank was extensively involved in the district directly because of large ownership of lands and mortgages. (R. 472, 473, 503.) The Bondholders' Committee at this time represented over 80% of the bondholders and desiring to learn the wishes of the bondholders on January 7, 1935, submitted to them a questionnaire (R.

958) calling for a vote by the bondholders as to whether they desired (1) the cash settlement (i. e., 51¢ in cash) or (2) the former refunding plan. No other alternative was submitted to them. In the questionnaire the Committee members stated that they considered the cash offer "unduly low". The bondholders (63% of the total) indicated their preference for the cash offer plan. The Committee thereupon, acting upon and in accordance with this vote, voted by a majority of 8 to 5 in favor of the plan (R. 501) which provided for liquidation of the bondholders' holdings on the basis stated. Certain large bondholders were individually represented on the Bondholders' Committee. Of these, James Irvine, the Bekins estates, West Coast Life Insurance Company, Charles D. Bates and former Governor James N. Gillett withdrew their bonds and have consistently opposed the Cash Offer Plan. The only large bondholder represented on the Committee which did not withdraw was the Bank of America. (R. 885, 504.)

Arrangements were made to carry out this plan and on October 4, 1935 (the Bankruptcy statute under which this proceeding is brought was passed in 1937), over $14,000,000 (i. e., over 86%) of bonded indebtedness of the foregoing bond issues was deposited and surrendered and the owners thereof received their $515.01 per bond. (R. 344.) It is contended by the district that the R. F. C. owns these bonds at their full face value and is entitled to vote them. This is one of the principal issues in the case. The district contends that the arrangement between the R. F. C. and the district resulted in the relationship of vendor and vendee, and appellants contend that it resulted in the relationship of debtor and creditor, the interest of the R. F. C. being at most that of a pledgee.

After the enactment of the first Municipal Bankruptcy Act, on May 24, 1934, the Merced Irrigation District, on April 19, 1935 (Ex. OO, p. 41), filed a petition in bank-

ruptcy in the District Court setting forth a plan identical with the Cash Offer Plan and the plan of composition involved in this proceeding. Substantially all the appellants here appeared there and contested the issues setting up substantially the same objections as are here urged.

The Bondholders' Committee filed a consent to the plan on behalf of the bondholders who had voted to accept the Cash Offer Plan, and a few scattered individuals also filed consent to the plan. Authority was given by the depositors under the Cash Offer Plan to consent to a proceeding under Section 80 of the Bankruptcy Act (the former statute). (R. 584, 593, where the Cash Offer Plan is set forth.)

After a trial on the merits, the District Court on March 4, 1936, rendered its decree confirming the plan. An appeal was thereupon taken to this Court where the cause was reversed, with directions to dismiss, on April 12, 1937 (R. 107), as reported in 89 Fed. (2d) 1002. By this time the *Ashton* case had been decided in the United States Supreme Court, but nevertheless the Merced Irrigation District applied to the United States Supreme Court for a writ of certiorari which was denied by that Court on October 11, 1937, 58 Sup. Ct. 30.

The decree of dismissal entered pursuant to the mandate in the former cause (R. 964) on July 6, 1937, was in terms unqualified.

The plea of *res adjudicata* was raised by the appellants in this case and is one of the principal issues.

During the pendency of said proceedings in the Supreme Court, the Merced Irrigation District nevertheless, on July 20, 1937 (R. 809), filed a petition in the Superior Court of Merced County under the provisions of California Statutes 1937, Chapter 4, for confirmation of the same plan of composition. In this case the R. F. C. filed

a purported consent dated July 9, 1937. (R. 823.) This case likewise went to trial and it was contested by substantially the same objectors. After that cause was submitted to the judge he rendered an opinion on October 5, 1937 (R. 970), in favor of the Merced Irrigation District and ordered the preparation of findings and a decree in accordance with his opinion. No findings, however, were ever presented by the district. The pendency of those proceedings is raised in bar of these proceedings.

The present proceedings were inaugurated by the filing of a petition in the lower Court on June 17, 1938 (R. 8), whereupon the appellants appeared by answer, filed claims, and set up their defenses. The cause went to trial before Hon. Paul J. McCormick in November, 1938. The hearing was upon the isues raised including a controversy as to whether the R. F. C. was a creditor affected by the plan. This latter issue was raised by motion, of which due notice had been given to the R. F. C. (R. 139, 145, 341.) The R. F. C. failed, however, to appear. It likewise failed to file any claim in these proceedings; and its consent (R. 644) does not directly allege ownership by it of the bonds. On January 10, 1939, the District Judge rendered his opinion which is reported at 25 Fed. Supp. 981. (R. 168.) Thereafter an interlocutory decree was presented and objections to the findings and decree were made. (R. 196, 204.) These were disallowed and the decree signed February 21, 1939. (R. 220.) Thereafter appellants made a motion for a new trial, which it is their contention should have been granted. (R. 239, 267.) After the denial of this motion this appeal was taken. (R. 273, 268, 4.)

Section 83 does not excuse the failure of the R. F. C. to file its claim, even if the claim should be regarded as a loan secured by a pledge of bonds. If, as we contend, the R. F. C. was required to file its claim, it was plainly error to enforce the plan of composition.

FIRST PROPOSITION: THE RECONSTRUCTION FINANCE CORPORATION IS NOT A CREDITOR AFFECTED BY THE PLAN OF COMPOSITION AND ITS CONSENT IS NOT ENTITLED TO BE CONSIDERED.

Assignments of error:

"20. The court erred in finding and holding that the Reconstruction Finance Corporation is a creditor affected by the plan."

"21. The court erred in finding and holding that the Reconstruction Finance Corporation is the owner or holder of the original bond issues of the Merced Irrigation District entitled to vote on the plan of composition herein." (R. 285.)

"30. The court erred in finding that said plan was not prepared or substantially completed or executed several years before the commencement of this proceeding, and in finding that said plan is a plan of composition pursuant to said Chapter IX." (R. 286.)

By Section 83 of the Bankruptcy Act the petition must allege that not less than 51 per centum in amount of the securities *affected by the plan* (excluding however any such securities owned, held or controlled by the petitioner) have accepted it in writing. By the same section it is provided that not less than ten days prior to the time fixed for the hearing any creditor of the petitioner *affected by the plan* may file an answer.

By the same section (subdivision b) it is provided the plan of composition shall not be confirmed until it has been accepted in writing by or on behalf of creditors holding at least two-thirds of the aggregate amount of claims of all classes *affected by the plan.*

In subdivision (a) of the same section it is provided that "No creditor shall be deemed to be affected by any plan of composition unless the same shall *affect his interest materially,* * * *".

In Section 82 it is provided that the term "security affected by the plan" means security as to which the rights of the holders are proposed to be adjusted or modified materially by the consummation of the composition agreement.

The term "affected by the plan" of course means adversely affected by the plan.

The real question is whether or not Reconstruction Finance Corporation made a loan to the district. If it did, then the bonds which it holds are either effectively retired or are collateral to the loan, and the district's obligation is the amount of the loan, and the obligation owing to the R. F. C. is not affected by the plan of composition. In other words, the question is, what is the obligation of the district to the R. F. C.? If it is an obligation according to the terms of the deposited bonds, the district does not owe the R. F. C. anything on a loan. If there is a loan, the district has no obligation on the bonds except to the extent that they might possibly be enforced as security in liquidating the loan.

As counsel for petitioner reiterated in the Court below (R. 361, 385), the relationship is determined by the actual contracts in evidence, though respondents go a step further and say that the true nature of the contracts is also demonstrated by the conduct of the parties thereto.

The operative documents making up the contract with the R. F. C. are:

1. Resolution of the R. F. C. granting a loan, dated November 14, 1934. (Ex. OO, p. 155.)

2. Acceptance of the loan by the district, on December 11, 1934. (Ex. OO, p. 180.)

3. Resolution of petitioner adopting refunding plan. (Ex. OO, p. 183.)

4. Agreement between R. F. C. and the district. (Ex. OO, p. 217.)

5. Refunding bond purchase contract. (Ex. OO, p. 202.)

6. Proposition voted on by electors of district. (R. 603.)

7. Order No. 54 of California Districts Securities Commission. (R. 949.)

8. Deposit Agreement of original bondholders. (R. 576.)

We now show that these documents demonstrate that the Reconstruction Finance Corporation granted the district a loan secured by bonds surrendered to R. F. C. Taking up the documents in order, we find:

1. The resolution of the R. F. C. granting a loan stated that the district had "applied to this Corporation for a loan to enable it to reduce and refinance its outstanding indebtedness, pursuant to the provisions of Section 36, Part 4, of the Emergency Farm Mortgage Act of 1933, as amended", and that the Reconstruction Finance Corporation had appraised the district, determined that it was economically sound, and therefore

> "authorized a loan to or for the benefit of the Borrower of not exceeding $8,600,000.00 plus 4% interest."

The district paid the R. F. C. $750 for the appraisal. (R. 547.) The resolution further provided that the loan should be evidenced by 4% "New Bonds" equal in amount to the loan, *but if the district should, before delivery of the new bonds, repay the advancements to the Reconstruction Finance Corporation, with 4% interest, the obligation would be terminated.* (p. 165 of Ex. OO.)

The resolution also provided that the district should levy taxes "proportional to the reduction in the corresponding annual requirements for principal and interest

of the outstanding indebtedness'' and should make reports and keep its affairs acceptable to the R. F. C.

This resolution provided that disbursement should be made only if all outstanding bonds were deposited, but this was later amended to provide that disbursement would be made upon deposit of 85% of the bonds. (Pet. Exs. 4 and 5.)

It can hardly be said that the foregoing resolution means anything but that the R. F. C. granted a loan to the district.

The second document of interest is the resolution of the directors of the district adopted December 11, 1934 (p. 180 of Ex. OO), by which the district accepted the loan:

> ''this resolution shall constitute an agreement by the Borrower with Reconstruction Finance Corporation whereby the Borrower accepts the benefits of such loan.''

The third paper is the resolution of the directors of the district adopting a refunding plan for issuance of new bonds in the sum of $8,600,000 to evidence the loan granted by the R. F. C. upon application of the district. (p. 183 of Ex. OO.)

The fourth paper is an agreement between the R. F. C. and the district, dated August 14, 1935. (p. 217 of Ex. OO.) It recited that

> ''the District represents that over 85 per cent of its outstanding indebtedness is now available for refinancing on the basis provided for in the Resolution authorizing the loan;''

and provided that during the time the Reconstruction Finance Corporation holds any of the old securities and the same have not been refinanced by delivery of new bonds, the district will anually levy and pay to the Reconstruction Finance Corporation

> "four per cent upon the total amount of the disbursements made to or for the benefit of the District in acquiring such Old Securities."

The fifth document in the chain (p. 202 of Ex. OO) dated September 16, 1935, is an agreement that the district will issue and the R. F. C. will purchase not more than $8,600,000 of refunding bonds, and that

> "R. F. C. shall be under no obligation to purchase refunding bonds beyond the amount necessary, in its judgment for refunding the indebtedness owed to creditors of the Borrower who join in the plan of refinancing, contemplated by a resolution of R. F. C., authorizing this loan and adopted November 14, 1934. In the event any of the refunding bonds are sold to purchasers other than R. F. C., the principal amount of bonds which R. F. C. is obligated to purchase shall be correspondingly reduced." (Ex. OO, pp. 205, 206.)

Paragraph 6 of the contract provides for payment of interest and for a reserve fund for payment of refunding bonds, and paragraph 7 provides for the allocation of power revenues to payment of the refunding bonds.

The sixth document is the proposition on which the electors of the district voted. (R. 603.) This was a proposal to issue refunding bonds to repay the advances to be made by the R. F. C. In other words the authority of the directors of the district to make a contract was limited to the issuance of refunding bonds to repay the R. F. C. loan. (California Irrigation District Act, secs. 30c, 30e, 31, 32a.)

Furthermore, Sections 3 to 9 of the California Districts Securities Commission Act provided for the certification by that Commission of the new bonds as legal investment for trust funds and banks and for a determination that the bond issue did not exceed 60% of the security for the bonds. (Cal. Stats. 1931, p. 2263.)

Order No. 54 (R. 949) of the Commission (the seventh document) is such authorization. It limits the district's authority to the issuance of refunding bonds (Sec. 3) "to repay the Reconstruction Finance Corporation for equal amounts of loans provided by said corporation for the payment of the district's present outstanding bonds. * * *"

In handling the old bonds and the loan to the district, the R. F. C. wrote a letter of instructions (R. 557) to the Federal Reserve Bank at San Francisco directing the latter to pay to respective "depositaries" 51.501 cents per dollar principal for bonds of the district. The letter further directed the Federal Reserve Bank to semi-annually present interest coupons to the district "in face amount as nearly as possible equal to, but in no event less than interest at four per centum (4%) per annum upon the aggregate amount disbursed pursuant to this letter. The amount collected on account of such coupons should exactly equal the amount of such interest".

This instruction was later changed. The bonds were registered, after removal of all coupons, and the district was billed for interest on the R. F. C. loan as such. (R. 353, 354.) No coupons were ever presented by or on behalf of the R. F. C. (R. 353.)

The bonds, according to the letter, were to be accompanied by "Memorandums of Sale and Receipt" executed by each respective depository, the latter documents stating:

> "The undersigned proposes to distribute the proceeds of this sale to the creditors of the above District, who have deposited securities with the undersigned, in amounts and manner as contemplated by the resolution of Reconstruction Finance Corporation authorizing a loan to said District, * * *." (R. 572 and 573.)

The original bondholders deposited their bonds by following the instructions given in a letter dated February

15, 1935 (Petitioner's Exhibit 13, R. 586) from the Bondholders' Committee to the bondholders stating that deposits of bonds by those wishing to accept the "Cash Offer Plan" should be made with certain depositaries, and that the bonds already with the Committee and not withdrawn would be deemed to have accepted the plan.

The eighth document, "Letter of Transmittal and Acceptance of Cash Offer Plan" (R. 584), used by the original bondholders in depositing their bonds with the depositaries, stated:

> "Such bonds are delivered to you as Depositary and are deposited subject to and for the use and purpose stated in the Cash Offer Plan dated February 1, 1935, adopted by Merced Irrigation District Bondholders' Protective Committee."

Analyzing the foregoing papers, it is plain that the R. F. C. agreed to loan *the district* $8,600,000 to reduce the latter's bonded indebtedness. This was indeed all the R. F. C. could do under Title 43, Sec. 403 U. S. C. It was agreed between the R. F. C. and the district that the money should be paid out to bondholders upon deposit of their bonds when at least 85% of outstanding bonds had been deposited. The district may repay the loan in either of two ways. It may either (a) deliver its refunding bonds as evidence of the loan and the old bonds are to be cancelled, or (b) tender the amount of the R. F. C. loan in cash (obtained by sale of the refunding bonds to investors, or obtained in any other way), in which event the old bonds are to be cancelled. Until the payment or the delivery of refunding bonds, the district's only obligation is to pay 4% interest upon the moneys advanced by the R. F. C.

In no way, therefore, is the R. F. C. affected by the plan, whether "materially" or otherwise. It loans its money and gets equal amounts of refunding bonds or re-

payment in cash. That is the beginning and end of the transaction for the Reconstruction Finance Corporation.

If it can be said at all that the R. F. C. holds the old bonds as unretired obligations, such holding cannot be more than as collateral to the loan. The deposited bonds are thus spoken of in some of the papers in evidence and in some of the testimony:

> "Those bonds were delivered to the Reconstruction Finance Corporation and are held as collateral on the loan to the District." (Testimony of B. P. Lester, secretary of the Bondholders' Committee, R. 499.)
> "the pledging of Deposited Securities to this Corporation." (p. 176 of Ex. OO.)

A letter from the Reconstruction Finance Corporation to the district, dated March 8, 1938, stated:

> "The records in this office indicate that *we hold as security for our advances* old bonds of the District in a principal amount aggregating $14,681,000.00, while the outstanding obligations still to be refinanced total $1,746,942.62." (R. 792.)

Even when the R. F. C. brought suit against the district on some of these old bonds (doing so at the suggestion of the attorney for the district, R. 386, 388), apparently in an effort to make a showing as holder of the bonds, the district agreed to and did pay the fees of the attorney for the R. F. C. (R. 380.)

The old bonds were never enforced against the district, but rather the obligations enforced were those under the loan arrangement. Taking the agreements of the parties as a whole, it must be found that as to any holder of old bonds after deposit and payment therefor, the beneficial interest in the bonds rested in the Merced Irrigation District. If the R. F. C. did undertake to enforce the old bonds according to their terms, it could do so solely as trustee for the district since it has asumed a fiduciary

obligation and relationship to the district, whether as pledgee or trustee.

Apart from the papers mentioned, there are other papers and actions which demonstrate conclusively that the Reconstruction Finance Corporation is not a creditor affected by the plan of composition and entitled to vote thereon, among which are the following:

1. **The papers in evidence uniformly speak of the transaction as a loan.**

In this connection it should be remembered that it is the relationship *between the Reconstruction Finance Corporation and the district* which determines whether or not the Reconstruction Finance Corporation is a creditor affected by the plan. If *as against the district* it asserts only a loan which is not to be reduced, it is not a creditor affected by the plan.

The papers heretofore quoted from and which form the basis of the matter, all refer to the transaction with the district as a *loan.*

"Negotiations for a loan." (R. 759.)

"The Reconstruction Finance Corporation has authorized a loan to the Merced Irrigation District which will enable the District, conditioned upon an agreement being affected between the District and its bondholders, to pay $515.01 for each $1,000 bond." (R. 761.)

"the loan will expire" (R. 762)

"when the loan was recommitted." (R. 795.)

"they desire to obtain confirmation of the unpaid balance on your loan." (Letter from Reconstruction Finance Corporation, R. 796.)

"should make or grant a loan to said District * * *."

"A loan had been granted." (R. 799.)

"to evidence said loan * * * out of the proceeds of said loan." (R. 818.)

"That such payment be made out of the proceeds of a loan in the sum of Eight Million Three Hundred Thirty-eight Thousand Eleven and 90/100ths Dollars." (R. 821.)

"authorized a loan." (R. 858.)

"a loan for purposes of refinancing * * * authorized a loan." (R. 868.)

"by accepting said loan." (R. 951.)

"refunding bonds be issued to repay the Reconstruction Finance Corporation for equal amounts of loans provided by said Corporation." (R. 952.)

In 1935, the district brought an action in the Superior Court of Merced County, California, for validation of the refunding bonds to be issued. The judgment therein stated that the district on December 16, 1933, had filed an "application for a loan" with the Reconstruction Finance Corporation and on November 14, 1934, the R. F. C. "authorized a loan to or for the benefit of said district of not exceeding $8,600,000". (R. 600.)

"money loaned by the Reconstruction Finance Corporation." (From minutes of directors of the district, R. 378.)

"Your attention is directed to the formal resolution of this corporation authorizing loan to the above district." (Letter from Chief Engineer of R. F. C., R. 374.)

"This Corporation has authorized a loan of not to exceed $8,600,000 for the purpose of enabling Merced Irrigation District of Merced, California, to reduce and refinance its outstanding indebtedness." (Letter of R. F. C. to Federal Reserve Bank, R. 557.)

When the parties themselves have designated the transaction as a loan, it should not be open to question.

2. **The R.F.C. and district have repeatedly acknowledged that the indebtedness of the district to the R.F.C. is the R.F.C. loan, and not the old bonds.**

"Principal Indebtedness Due R.F.C. $7,560,185.69."

(From annual report of district to R. F. C., dated December 31, 1937, R. 774, see also p. 778.)

"Principal Indebtedness Due R.F.C. $7,564,303.77."

(Report of July 15, 1938, R. 785.)

In a letter to the district from the R. F. C., dated July 3, 1937, the following appears:

"Messrs. Haskins & Sells, Certified Public Accountants are now engaged in making an audit of our accounts. In connection therewith, they desire to obtain confirmation of the unpaid balance on your loan as of the close of business December 31, 1936 which according to our records was as follows:

Loan #		Unpaid Balance
#475		$7,487,569.28
475-A		51,501.00
	(in pencil)	7,539,070.28"

(R. 796.)

The books of the Federal Reserve Bank show the debt of the district to be only the amounts actually paid out for the bonds:

"Our bookkeeping system is such that an outstanding debt is shown. —the Merced Irrigation District is charged with the amount of the particular loan and with interest upon that in our ledger and as the several warrants have been paid the interest has been credited." (Testimony of Atkins of the Federal Reserve Bank, R. 355, 356.)

As noted, a letter from the R. F. C. to the district, of March 8, 1938, stated:

"The records in this office indicate that we hold *as security for our advances* old bonds of the District in a principal amount aggregating $14,681,000, while

the outstanding obligations still to be refinanced total $1,746,942.62.'' (R. 792.)

The fact that the Merced Irrigation District submitted to the R. F. C. statements of income and disbursements and balance sheets which showed the amount of the advances made by the R. F. C. as the total amount of the obligation of the district, and which showed no liability whatsoever on the bonds acquired by the R. F. C., which statements were accepted by the R. F. C., show the manner in which the transaction was regarded by both parties, and, in fact, constituted an account stated.

Also, the fact that the books of the R. F. C. show the total obligation of the district to be merely the amount of the advances, and the acknowledgment of the correctness of such statements, likewise show the loan nature of the transaction and constitute an account stated between the parties.

Interest has been paid only on advancements.

Respondents' Exhibit E (R. 764) shows the interest payments made by the district to the R. F. C.:

12-31-35	33545	10- 4-35 to 12-30-35	71,256.72
1- 7-36	33575	12-31-35	7.51
6- 6-36	34029	1- 1-36 to 6-30-36	149,576.48
12-29-36	35288	7- 1-36 to 12-31-36	151,889.71
6- 8-37	36239	1- 1-37 to 6-30-37	149,542.11
11-30-37	37858	7- 1-37 to 12-31-37	152,411.78
6-21-38	38463	1- 1-38 to 6-30-38	150,000.28

These payments represent interest at 4% per annum on the amounts advanced by the R. F. C. for the periods mentioned.

A demand for payment, check and voucher comprised the papers used for each interest payment. The forms used for the December 31, 1936, interest are set out in the transcript at page 755, and those used on other interest paying dates were the same in form.

An example is the demand by R. F. C. dated December 22, 1936, which read:

> "Following is a statement of your indebtedness to the Reconstruction Finance Corporation for * * * interest which * * * will become due and payable on Jan. 1, 1937.
>
> "Interest is computed on the daily balance of the principal beginning with the date the proceeds of the loan were disbursed for the actual number of days on the basis of 365 days to the year." (R. 757.)

Pursuant to this demand, the Board of Directors of the district adopted a resolution in part as follows:

> "Upon motion of Director Wood, seconded by Director Wolfe, all bills presented were approved and * * * warrant No. 35,288 in favor of the Federal Reserve Bank of San Francisco, being for interest on money loaned by the Reconstruction Finance Corporation for the period July 1, 1936 to January 1, 1937, in the sum of $151,889.71 was ordered paid out of the refunding bond interest fund." (R. 378.)

Mr. Atkins, of the Federal Reserve Bank, testified:

> "No coupons have ever been presented but a short time prior to each semi-annual interest date we sent down a notice of interest due." (R. 353.)
>
> "RFC has not demanded payment of us of any interest coupons on the old bonds at any time." (Testimony of Neel, R. 373.)

The fact that no coupons were presented indicates, of course, that the interest payments were not on the old bonds but on the *loan,* the only obligation of the district to the R. F. C.

3. **The fact that the district, with its own funds, participated in payments to bondholders and paid refinancing expenses further shows there is no obligation of the district to the Reconstruction Finance Corporation on the deposited bonds.**

Mr. Neel, auditor and treasurer of the district, testified:

> "It is a fact, however, that all of those bondholders who were paid anything on account of their bonds on or prior to October 4, 1935 did receive something in addition to the sum of $515.01 on a $1,000 bond and the additional consideration was paid by Merced Irrigation District pursuant to the old original resolution of November 14, 1934 and the acceptance thereof." (R. 366.)

The amount of such payment was $168,027.31. (R. 368.)

Mr. Neel also testified:

> "In addition to the District's paying this sum of $168,027.31 the District also agreed in the accepting of the resolution of November 14, 1934 that it would pay all of the expenses of effecting the arrangement for the taking up of the bonds at $515.01. The expense was a heavy expense." (R. 369.)

This expense amounted to $120,306.94. (R. 371.)

By these payments the original bonds became securities owned or controlled by the petitioner.

4. **The setting up of reserve funds for the Reconstruction Finance Corporation also shows a loan arrangement.**

> "The District in addition to making provision for the semi-annual interest payment further set apart in a reserve fund a certain amount annually to meet the requirements of the RFC as set forth in the resolution of November 14, 1934 and annually we have placed in a reserve fund beginning with 1936 a certain sum of money. The reserve fund was actually set up in 1936 and $92,200.00 placed in the reserve." (Testimony of Neel, R. 369-370.)

"We have a second refunding bond interest fund in which there was at this time $676,132.34 and that is separate from the reserve fund. We have in the refunding interest account $676,132.34 and in the reserve account $373,860.60." (Testimony of Neel, R. 373.)

The Reconstruction Finance Corporation, if it purports to be an owner of bonds, has received the following valuable preferences:

(1) Interest on its advances;

(2) A pledge of a very valuable asset of the district, its power revenue;

(3) Control over the financial affairs of the district;

(4) The right to loan money to the district at 4% interest and the right to buy bonds of the district bearing such interest, payable as provided in the contract, and which, because of the low outstanding debt of the district and the security on such new bonds, can probably be sold at a very substantial profit to the R. F. C.

All of these preferences have put the R. F. C. in an entirely different position from that of appellants.

5. The R.F.C. is not entitled to be recognized as a creditor because it has not filed a claim.

The R. F. C. is not here maintaining that it asserts against the district a claim of some $16,000,000. It has filed no claim of any amount and nothing appears to indicate that it is affected by the plan of composition. Rather, it has merely filed an unverified "consent" to the plan *wholly devoid of any statement of ownership,* and it is the *district* which is claiming it owes the R. F. C. twice the amount of the R. F. C. loan.

Section 83(b) of the Bankruptcy Act provides that upon filing of the petition notice shall be given to creditors and

> "The judge shall prescribe the form of the notice, which shall specify the manner in which claims and interests of creditors shall be filed, or evidenced, on or before the date fixed for the hearing."

Notice of the hearing was given requiring creditors to file their claims, and respondents did so, but there is no claim on behalf of the R. F. C.

The reason for the astonishing fact that the R. F. C. filed no claim in this proceeding is apparent. The fact that in its "consent" the R. F. C. carefully avoided any statement that it owned the bonds (coupled with its failure to file any claim), shows that it was unwilling, in the face of its loan contract, to file a claim as creditor to the amount of the bonds. On the other hand, if it filed a claim for the amount actually owing, it would oust the Court of jurisdiction, by thus showing that it was not a creditor affected by the plan. And since it has not filed a claim, there is nothing before the Court to indicate that any creditor affected by the plan, or even claiming to be affected, has consented to it.

> "No creditor shall be deemed to be affected by any plan of composition unless the same shall affect his interest materially." (Sec. 83(a).)

6. The transaction summarized above resulted in a pledge.

In *Shelley v. Byers,* 73 Cal. App. 44, 238 Pac. 177, the complaint alleged that plaintiff was the owner of and entitled to the possession of certain property, which was denied in the answer. Whether plaintiff was the owner was the prime question in the case. The Court found for the plaintiff and entered judgment, which was reversed on this appeal.

The Shelley boys, who had conducted an army department store, went through bankruptcy.

Thereafter they entered into a contract with Gollober and Rosenberg, upon the face of which there was what purported to be a sale to them by the Shelley boys of certain property, including all of the stock in trade of the store, with a right to repurchase reserved to the Shelley boys.

Appellant's theory of the transaction is that it was a pledge. Respondent contends that the transaction was a sale with an optional right reserved to the vendors to repurchase.

The Court said, page 54:

> "Under our Statute a mortgagee of personal property in possession and a pledgee are practically, if not identically, the same. (Civ. Code, Sec. 2924 and 2987.) *No legal title passes in either case,* but merely the right of possession for the purpose of security. (Civ. Code, Sec. 2888.)"

At page 62:

> "That the parties intended the property to be held by (G. & R.) as security is unmistakably disclosed by certain strongly marked features shown on the face of the writing itself. In the first place, *the transaction had its inception in a negotiation for a loan,* or for what is the equivalent of a loan, to the Shelley boys, even if the latter did not become personally liable therefor. This is one of the principal *indicia* of a pledge." (Cases cited and quoted from.)

The case of *Union Securities Inc. v. Merchants Trust and Savings Company* (Ind.), 185 N. E. 150, 95 A. L. R. 1189, is quite analogous to the case of *Shelley v. Byers,* supra. The facts and the law thereof are amply covered in the headnote thereof as follows:

> "A transaction whereby accounts receivable are assigned to another is, though denominated by the

parties a sale of the accounts, in fact a loan, and the assignee of the accounts is not entitled to a preference out of the assets of the assignor in the possession of a receiver for the amount collected on such accounts by the assignor, where the arrangement was that the assignee should advance 88 per cent of the face value of the accounts assigned, pay over an additional 10 per cent when the accounts should be paid, and keep 2 per cent as its profit, that the assignor should become a surety for the payment of such accounts, and collect them at its own expense, and the assignor, with the assignee's knowledge had mingled the proceeds of collection with other funds in its general bank account, paying 2 per cent a month for such amounts as were due and not remitted to the assignee, and the customers whose accounts were assigned were not notified of that fact."

The issue in that case is identical to the issue to be determined in the instant case, and is well stated, page 1193:

> "The decisive question in this case is whether the transaction between appellant and the Retherford Manufacturing Company was a bona fide sale of accounts as claimed by appellant, or was the transaction in fact a loan and the accounts assigned as security?"

The Court then proceeds to define a sale and a loan quoting from Cyc.

Although the contract on its face purported to use words of purchase and sale, the Court held it to be a loan.

The Court therein also discussed the facts and quoted from the case of *In re American Fibre Reed Co.,* 260 Fed. 309, 318. There, too, the corporation sold the accounts to the petitioner, which were collected by the vendors at their expense, the proceeds to be applied first to the payment of the amount advanced by the vendee to the

vendors, and the remainder of the amounts collected went to the vendors for their own benefit. The amount paid by the vendee was about 75 per cent of the face amount of the accounts, and accounts so sold were stamped on the books of the vendors as sold to the petitioner. The Court held:

> "Insofar as the contracts in question here used words fit for a contract of purchase, they are mere shams and devices to cover loans of money at usurious rates of interest."

The Court also cited and quoted from the similar case of *Chase & Baker Co. v. National Trust and Credit Co.*, 215 F. 633, 638. Passing on the question whether the agreement to buy accounts was in fact an agreement of sale or loan, the Court said:

> "A court of equity will not be frustrated in ascertaining the real intention of the parties to make a usurious loan by the fact that parol proof thereof would contradict the written evidence of the apparent transaction."

In another similar case, *In re Grand Union Co.*, 219 Fed. 353, 359, the Court said:

> "Stripped of the verbiage with which the parties have sought to clothe their transaction, the naked facts disclose that what they are doing was not a sale, but a loan, and that the leases were turned over simply by way of security. The Grand Union Company needed money and the Hamilton Company advanced it."

The test is stated as follows, page 1195:

> "The test which determines whether the real transaction between the parties was a loan or a sale is the intention of the parties and their intention is to be ascertained from the whole transaction, including the conduct of the parties as well as their written agreement. The facts as disclosed by the finding show that the real intention of the parties was to effect a loan at a rate of interest not otherwise collectible."

In re Grand Union Co., 219 Fed. 353, certiorari denied in 238 U. S. 626, and appeal dismissed in 238 U. S. 647, the corporation transferred to a credit company certain leases of personal property owned by it. The credit company claimed to have purchased the same under a contract at various discounts according to the maturity of the leases. The Court pointed out that while it will ordinarily assume, where the parties in a written contract call a transaction a sale, that they have used the term correctly and in its technical sense, yet, if the contract goes on to set out in detail the facts of the transaction which merely disclose that what the parties call a sale is in reality not a sale but a loan or bailment or mortgage, the Court must decide according to the real nature of the transaction, without regard to the terms the parties apply to it.

In the case of *In re Rogers,* 20 Fed. Sup. 120, at page 129, there is a discussion as to what a pledge is, the principal point being that one of the elements of a pledge is the sole right of the party to require the payment of the sum for which the pledge was granted.

A debtor's note cannot be treated as collateral security for his own debt.

In the case of *Jones v. Third National Bank of Sedalia,* 13 Fed. (2d) 86, the debtor was indebted to the bank. Part of the debt was secured by Chattel Mortgages. The bank became apprehensive and the debtor gave a new note and chattel mortgage for any debts that are now owing or might be owing in the future. The first debt was paid, but the second note was retained for security for a new loan of $2400, for which the debtor gave a note reciting that the $5000 note was collateral. A further loan of $250 was made, but this note contained no recital of security. The bank filed its claim for the balance due on the $2400 and $250 notes and contended that its claim was a secured one by virtue of the $5000 note. The Court said:

> "Collateral security has been defined as some security additional to the personal obligations of the borrower."

Stating that collateral security necessarily implies the transfer to the creditor of an interest in some property, or lien on property, or obligation, and stated that *a debtor's additional promises to pay cannot be treated as collateral security for his debt, unless such additional promises are themselves secured by a lien on property, or by the obligations of third persons.*

In the case of *Union National Bank v. Peoples' Savings and Trust Co.,* 28 Fed. (2d) 326, the Union Bank loaned $17,500 to the Jersey Cereal Food Company, which gave its judgment notes therefor. Being unable to pay, it gave its gold notes aggregating $19,000 to the bank as further evidence of the original loan. A receiver was appointed. The District Court allowed only the part of the claim based on the $17,500 notes and this was affirmed on appeal. The Court said:

> "when insolvency occurs, he (the creditor) must share pro rata with all the other creditors upon the basis of his real debt regardless of whether he holds one note or two."

An additional promise of a debtor to pay money cannot, from the very nature of the case, be treated as collateral security for his own debt.

Dibert v. D'Arcy, 248 Mo. 617 at 643, 154 S. W. 1116;

In re Waddell-Entz Co., 67 Conn. 324 at 334, 35 Atl. 257,

and the note which is security will be void.

Where personal property is transferred by a debtor to a creditor, the presumption is that the transfer is made as collateral security for the debt.

Borland v. Nevada Bank of San Francisco, 99 Cal. 89.

In *Commercial Security Co. v. Holcombe,* 262 F. 657, the Court said:

> "The nature of a transaction is determined not by the name given to it by the parties, but by its operation and effect. That a transfer of paper evidencing indebtedness payable after the date of the transfer, and which does not include any interest, is not a sale, is quite obvious, when the transferer is required to pay to the transferee interest on the amount owing on such paper before anything is payable by maker, and the transferer has the right to reacquire the paper by paying to the transferee the sum it calls for the interest thereon."

7. The Reconstruction Finance Corporation had no authority in law to do other than make a loan to the district, and the district was authorized only to accept a loan.

The R. F. C.'s only authority to participate in refinancing programs of agencies like petitioner is contained in Section 36 of the Emergency Farm Mortgage Act. (Title 43, Sec. 403, U. S. C.) That statute calls for an "application" for a loan, requires that the purpose thereof be to "reduce and refinance its (the district's) outstanding indebtedness"; and before the loan agreement is made the R. F. C. must be satisfied that an agreement has been made between the "applicant and the holders of the outstanding bonds—under which the applicant will be able to purchase or refund all or a *major part of* such bonds at the price agreed".

The Court is referred further to the language of said Act which provides:

> "Such loan shall be subject to the same terms and conditions as loans made under Section 605 of Title 15 * * *."

This is the R. F. C. Act itself. This latter Act has been construed as *limiting the power of the Corporation to the making of loans;* and there is nothing in the Emer-

gency Farm Mortgage Act which would increase that power.

In *R. F. C. v. Central Republic Trust Company,* 17 F. Supp. 263, the Court said (p. 292):

> "There is no intimation of the intent (by Congress) to use the words 'loans', 'notes', and 'obligations' in any other than their usually accepted meaning."

The Court said (p. 293):

> "Plaintiff corporation (R. F. C.) was created and expressly authorized to make contracts for *loans,* and to sue and to be sued with reference thereto."

In the case of *Baltimore National Bank v. State Tax Commission,* 297 U. S. 209, 80 L. Ed. 850, 56 S. Ct. 417, in a decision written by Mr. Justice Cardozo, the Court discussing the capacity of the Reconstruction Finance Corporation said:

> "Until then there was no power on the part of the Reconstruction Finance Corporation to subscribe for such shares or indeed for any others."

In the case of *Continental National Bank v. Chicago, Rock Island & Pacific Ry. Co.,* 294 U. S. 648, 79 L. Ed. 1110, 55 S. Ct. 595, the Court said:

> "The Reconstruction Finance Corporation Act creates a corporation and vests it with designated powers. Its entire stock is subscribed by the Government but it is none the less a corporation limited by its charter and by the general law."

The R. F. C. was similarly incorporated for a public purpose, and not for private profit.

We also call to the Court's attention the California Act to authorize irrigation districts to cooperate and contract with the United States Government. (Stats. 1917, p. 243.) Section 11 thereof was amended (Stats. 1933, p. 2394) to provide:

"In addition to other powers in this act conferred, irrigation districts shall have authority to *borrow or procure* money from the United States or any agency thereof, for the purpose of *financing or refinancing* of the obligations of the district or the *funding* or *refunding* or *purchase* of the bonds of the district, or for any of the other purposes of the district authorized by the California Irrigation District Act, or acts amendatory thereof or supplemental thereto. As evidence of such *loan or loans* and the obligations of such district to repay the same to the United States or any agency thereof, any irrigation district, * * * may make and enter into contract or contracts with the United States or any agency thereof, as a condition or requirement to the making of such *loan or loans.* Such district may issue bonds of such district as may be required by the contract last above provided for or without such contract, containing such terms and conditions and payable in such manner and from such source or sources of income and/or revenue as may be agreed upon between * * * (them) * * * and may obligate and bind the district for the payment of such bonds according to the terms thereof. * * *."

By no stretch of the imagination can this Act be interpreted as authorizing the district to enter into any other form of contract than one of a loan to the district. It states in terms (Sec. 9) that it does not add any powers except as provided. See *Meyerfeld v. South San Joaquin Irr. Dist.,* 3 Cal. (2d) 409.

This act gives no authority to the district to deal in its own bonds, except to retire them with *loans,* and the contracts with the R. F. C. must be construed in the light of the district's authority.

We believe the foregoing definitely shows the R. F. C. to be merely a lender and not a creditor which can in good faith, or at all, give any acceptance to the plan of composition which can be here considered. The R. F. C. is

not entitled to more than its loan—at any time the district may liquidate its entire debt to the R. F. C. by paying off its loan rather than the face value of deposited securities. Such cannot be done with the appellants and this immediately demonstrates that the R. F. C. is in an entirely different class from appellants.

From the time of the R. F. C. disbursement, it has been getting interest and has by contract tied up the district's assets as security for its loan. The difference of treatment between the R. F. C. and appellants is enough to determine that they are in entirely different classes and the purported consent of one has no bearing on the other.

Unless it be determined that the obligation to the R. F. C. is merely that of a loan, most of the documentary evidence in this case is meaningless, and, in fact, the "Cash Offer Plan" itself was an empty gesture.

In the absence of a claim by the R. F. C., and in view of the loan agreements with the district, and in view of the fact that the district's obligation is directly measured by the statement that:

> "* * * if the Borrower shall, before any New Bonds are delivered to this Corporation, pay or cause to be paid to this Corporation an amount equal to the disbursements it has made to or for the benefit of the Borrower with 4% interest thereon until paid, this Corporation will thereupon surrender or cause to be surrendered the Old Securities then held by it or on its behalf to the Borrower." (Ex. OO, p. 165.)

it appears conclusively that the Reconstruction Finance Corporation is not a creditor affected by the proposed plan of composition, and is not entitled to vote on it as against appellants.

8. No provision in the statute permits debts that have been extinguished to be treated as still existing for any purpose.

We have just shown, we submit, that the facts and relevant rules of law call for the conclusion that the debt of petitioner to R. F. C. is the amount of the R. F. C. loan and no more.

We now observe that no provision in the statute permits debts that have been extinguished to be treated as still existing for any purpose. For lack of space we refer on this point to the brief filed herein by Brobeck, Phleger & Harrison as attorneys for Florence Moore, et al. In that brief (under a heading identical with the heading next above) the above proposition is shown to be sound, primarily for two reasons:

(1) No provision in the Municipal Bankruptcy Act can be rationally construed as intended to provide that a district which, long before the enactment of the bankruptcy act in question, had reduced its indebtedness to a point well within its means, may nevertheless further reduce its debts on the theory that in two years before the bankruptcy statute in question was passed, its debts exceeded its ability to pay.

(2) The only provision which could possibly be argued as intended to have this effect is in any event inapplicable under the rule against retrospective interpretation.

9. The plan has been fully executed out of Court as to the deposited securities.

Disbursements have been made to cover all claims the original consenting bondholders could have on their bonds. They have surrendered their bonds, taken their money, and have gone their way. They are not parties in this proceeding nor could they be, for their deal has been fully consummated.

Neither the R. F. C. nor the district can now withdraw from the loans which have been committed and accepted. All of the rights of the original bondholders of the R. F. C. and of the district, to the extent of the deposited bonds and loan (on which time limits have expired) have become fixed and vested, and the transaction fully executed. It cannot therefore be contended that only for the purposes of this proceeding the status of the parties should be considered as it was five years ago, before disbursement was made.

In the case of *In re West Palm Beach,* 96 Fed. (2d) 85, the Court had before it a situation where the city had before passage of Section 83 carried out a plan to the extent of exchanging the securities involved, leaving, however, a minority of original bonds outstanding. The city sought, after Section 83 was enacted, to compel the minority bondholders to accept the plan.

The Court said:

> "In bankruptcy matters composition has a special meaning, to-wit, a settlement or adjustment which is enforced by the court on all creditors after its acceptance by a required majority. A proposed adjustment out of court is not a plan of composition, but it may become one by being presented to the court."
>
> "* * * the plan with its acceptance became incapable of presentation as a composition because it has been largely executed."
>
> "The owners of these were no longer acceptors of an executory plan, but had been fully settled with under it and had no longer had any direct interest in it. They could not fairly be counted as voters before the court on the propriety of the plan. Of course they would wish the nonacceptors to be forced to scale their debts as they themselves had done. They could no longer have an open mind as to whether, in the light of developments, the plan was a good one or a bad one."

10. The R.F.C. and the district are bound by proceedings in the State Court.

The district in 1937 filed its proceeding under Cal. Stats. 1937, Ch. 24, to refinance its indebtedness, offering the identical plan proposed in this proceeding, with the same creditors involved. The R. F. C. filed its acceptance of the plan in that proceeding. (R. 820.) It and the district are therefore bound by those proceedings and Section 19 of said chapter, which provides:

> "Consent of Accepting Bond or Warrant Holders Not Affected by Invalidity of any Portion of this Act or Dismissal of Petition. In the event that said petition for liquidation, refinancing or readjustment is dismissed, or that any of the provisions hereof for confirmation of the plan or acquisition of the bonds or warrants of the nonaccepting holders shall be declared invalid, such dismissal or declaration shall not affect the effectiveness of the plan with respect to the district or holders of bonds or warrants accepting the same."

In other words the acceptance of the plan proposed in the State Court proceeding which was identical with the plan here proposed (R. 809), was, under the terms of the State statute, an unconditional and irrevocable agreement by the R. F. C. to accept refunding bonds equal in amount to the amount of their loan to the district. Quite apart, therefore, from the numerous other considerations above discussed, the acceptance filed by the R. F. C. in the State proceeding makes it impossible for the district to maintain either that the R. F. C. is now a creditor affected by the plan in the present proceeding or that it is a creditor of the district beyond the amount of its loan.

SECOND PROPOSITION: PETITIONER IS BARRED FROM OBTAINING CONFIRMATION OF ITS PROPOSED PLAN OF COMPOSITION BY REASON OF ITS LACK OF GOOD FAITH AND CONSTRUCTIVE FRAUD.

Assignment of Error No. 12 reads:

"The offer of the plan and its acceptance are not in good faith". (R. 284.)

(See also assignments 68; R. 294; and 113, R. 306.)

1. If a petitioner seeking relief under the Bankruptcy Act comes into Court with unclean hands, or is guilty of any unfairness or lack of good faith, such petitioner is barred from relief regardless of the merits of the plan of composition.

Section 83, Chapter IX, Bankruptcy Act;

Tennessee Pub. Co. v. American Nat. Bank, 299 U. S. 18, 57 S. Ct. 85, 81 L. Ed. 13;

In re Tennessee Pub. Co., (C.C.A., 6) 81 Fed. (2d) 463;

In re Wisun & Golub, Inc., (C.C.A., 2) 84 Fed. (2d) 1;

Sophian v. Congress Realty Co., (C.C.A., 8) 98 F. (2d) 499;

Tellier v. Franks Laundry Co., (C.C.A., 8) 101 Fed. (2d) 561;

In re Barclay Park Corp., (C.C.A., 2) 90 Fed. (2d) 595;

In re Day & Meyer, Murray & Young, Inc., (C.C.A., 2) 93 Fed. (2d) 657;

In re Milwaukee Corporation, (C.C.A., 7) 99 Fed. (2d) 686;

Provident Mutual Life Ins. Co. v. University Evangelical Lutheran Church, (C.C.A., 9) 90 Fed. (2d) 992.

Equitable principles of course govern in bankruptcy.

Bardes v. Hawarden Bk., 178 U. S. 524.

Chapter IX of the Chandler Act, under which this proceeding is brought, after providing, in Section 83a, for the filing of the petition and what it shall contain, has this provision:

> "Upon the filing of such a petition the judge shall enter an order either approving it as properly filed under this chapter, if satisfied that such petition complies with this chapter and *has been filed in good faith, or dismissing it, if not so satisfied.*" (Italics ours.)

In Section 83e of the same chapter it is provided that at the conclusion of the hearing the Court shall make written findings of fact and its conclusions of law, and shall enter an interlocutory decree confirming the plan, if satisfied that

> "(1) It is fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors; * * * (5) the offer of the plan and its acceptance are in good faith; * * * If not so satisfied, the judge shall enter an order dismissing the proceedings."

While we have not found any cases arising under Chapter IX of the Bankruptcy Act construing these provisions, practically identical provisions in Chapter X, involving corporate reorganizations, and the old Section 77B, have been construed in the cases above cited. For example, Section 141 of Chapter X as to approval or dismissal of the petition when filed is almost identical with the above quoted provision of Chapter IX. Section 221 in Chapter X provides that the judge shall confirm a plan if satisfied, among other things, that

> "(2) the plan is fair and equitable, and feasible; (3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means of promises forbidden by this Act."

By their terms, some other provisions of the Bankruptcy Act, and particularly Section 29 of the Chandler Act designating offenses under the Bankruptcy Act are applicable to Chapter IX.

Section 29, Subsection f, distinctly provides that the term " 'bankrupt', wherever used in that section, shall include a 'debtor' " by or against whom a petition has been filed proposing an arrangement or plan under this Act.

Reference is here made to Section 29 for a long list of offenses prohibited in cases under the Bankruptcy Act under which this proceeding is brought. Obviously, a violation of any such provisions would constitute such lack of good faith as to require the Court to dismiss the petition.

Thus it has been held that a concealment of assets by a petitioner for corporate reorganization (forbidden by Section 29) would bar any relief under the Act.

In re Wisun & Golub, Inc. (C.C.A., 2) 84 Fed. (2d) 1.

Similarly, efforts to hinder, delay or harass creditors are such a lack of good faith as to bar relief under the Bankruptcy Act.

In re 1688 Milwaukee Corp., (C.C.A., 7) 99 Fed. (2d) 686;

In re Grigsby-Grunow Co., (C.C.A., 7) 77 Fed. (2d) 200;

First Nat. Bank v. Conway Road Estates Co., (C.C.A., 8) 94 Fed. (2d) 736;

Price v. Spokane Silver & Lead Co., (C.C.A., 8) 97 Fed. (2d) 237.

Similarly, the uttering of false statements of financial condition, or making any other false representation, re-

gardless of motive, in a bankruptcy proceeding, is sufficient to bar any relief under the Bankruptcy Act.

In re Wisum & Golub, Inc., (C.C.A., 2) 84 Fed. (2d) 1;
In re Keller, (C.C.A. 2) 86 Fed. (2d) 90;
In re Parsons, (C.C.A. 2) 88 Fed. (2d) 428;
In re Marshall, (C.C.A. 2) 47 Fed. (2d) 209;
In re Slocum, (C.C.A. 2) 22 Fed. (2d) 283;
Shanburg v. Saltzman, (C.C.A. 1) 69 Fed. (2d) 262;
In re Eastham, (D.C., S.D. Tex.) 51 Fed. (2d) 287;
Bankruptcy Act, Sec. 29, Subsec. b, (2).

Similarly, the proposal of a plan of reorganization which results in taking away from the creditors rights and property for the benefit of the debtor, is such bad faith as to prevent confirmation of a plan of reorganization.

Sophian v. Congress Realty Co., (C.C.A. 8) 98 Fed. (2d) 499;
Wayne United Gas Co. v. Owens-Illinois Glass Co., (C.C.A. 4) 91 Fed. (2d) 827:
In re Barclay Park Corp., (C.C.A. 2) 90 Fed. (2d) 595.

2. Petitioner is barred from any relief under Chapter IX of the Bankruptcy Act because it collected $717,932.50 of Trust funds belonging to the bondholders which it intentionally and permanently diverted to its own use.

The undisputed facts as testified to by Mr. Neel, auditor for the petitioner, are as follows:

The last tax levy made for the purpose of paying bonds and interest on bonds by Merced Irrigation District was the levy of 1932-1933. (R. 413.) The collections on the levy made for the year 1932-1933, prior to December 31, 1932, were not sufficient to pay principal and interest maturing

January 1, 1933. (R. 411.) However, there were very heavy collections after that time. The aggregate amount of which exceeded the amount necessary to pay principal and interest due January 1, 1933. After paying bonds and interest maturing January 1, 1933, the district *took out of its bond fund* all moneys levied and collected for the purpose of paying interest and principal of bonds and *used those moneys for general purposes, other than paying the maturity of the principal and interest upon the bonds maturing July 1, 1933, and subsequently.* (R. 412.) In the words of Mr. Neel, as set forth in the Record:

> "When the district made the levy for 1932-1933, it levied in the light of the maturities upon the principal and interest of the bonds which would occur on December 31, 1932, and also on July 1, 1933. Then instead of using the moneys for retiring the bonds maturing July 1, 1933, the district simply *emptied its bond fund* and *kept it empty thereafter,* except for the limited purpose of meeting the maturities of January 1, 1933 and prior thereto." (R. 412.)

Mr. Neel further testified that nothing by way of interest has been paid to any of the dissenting bondholders, beginning with interest due July 1, 1933, for which the said levy of 1932-1933 was made. (R. 423.) In addition to the moneys collected upon the levy made for the year 1932-1933, Mr. Neel testified that after December 31, 1932, there were additional moneys collected upon the levies made for the three years prior to the year 1932-1933, and that these moneys, which came into the district by way of payment upon delinquent levies, were taken by the district and used for general purposes. (R. 413.)

Mr. Neel further testified that the amount due to bondholders on July 1, 1933 was $454,200.00 and that there was collected, applicable to the payment of such sum, the sum of $320,272.93 from the levy for the year 1932-1933. Said amount of $320,272.93 *was placed in the general fund,*

and if it had been placed in the bond fund would have been available for payment of maturities upon those bonds due July 1, 1933. (R. 414.)

Mr. Neel further testified that he had made a computation for the purpose of determining the *total amount that would be in the bond fund today* as the result of the collection of the levy of 1932-1933, after paying maturities of December 31, 1932, and as a result of collecting delinquent taxes that were delinquent as of December 31, 1932 under prior levies, which embraced bond service, and found the total to be $717,932.50, including the $320,272.93 of 1932-1933 collections. (R. 414.)

According to the testimony of Mr. Neel, bonds and interest coupons maturing January 1, 1933 were unpaid and remained unpaid from that date to June 30, 1934. (R. 422.) No payment has ever been made on matured bonds and coupons maturing July 1, 1933 and subsequently. (R. 423.) Petitioner makes no effort to explain or justify its arbitrary action in refusing to apply these bond funds to the payment of the bond obligation for which purpose the money was collected.

Thus, during the period from December 31, 1932, to the time of trial $717,932.50 was diverted from the bond fund to the general purposes of the district, despite the fact that during all of that period large amounts of matured bonds and interest coupons remained unpaid.

Mr. Neel also testified that all of the rentals on land deeded to the district were diverted into the general fund. (R. 415.) Similarly, interest and penalties collected on delinquent assessments, and interest earned on bank deposits were placed in the general fund. (R. 421, 422.)

At the time of the trial, the undisputed evidence was that the petitioner Merced Irrigation District had on deposit in the bank cash in the sum of $1,578,446.00. (R. 669.) Nevertheless, in the face of that fact, counsel for the

petitioner, in answer to the direct question, as to whether it was the intention of the Merced Irrigation District to restore to the bond fund the sums referred to in the examination of Mr. Neel above described, replied that *it was not the intention to restore such funds.* (R. 523.) Furthermore, the testimony of Mr. Neel (R. 412) that "instead of using the moneys which came in as a result of this levy and retiring the maturities of July 1, 1933, *the District simply emptied its bond fund and kept it empty thereafter",* is sufficiently eloquent.

It is, therefore, undisputed that the diversion of the bond funds of the petitioner occurring subsequent to December 31, 1932, by which as was testified, the bond fund was kept empty, *was admittedly wilful and deliberate and remains so to this date.*

The bond fund from which such diversions were made is established by section 67 of the California Irrigation District Act (Stats. 1897, p. 254, as amended; Deering's General Laws, Act 3854), as it read at the time of the issuance of the bonds.

Selby v. Oakdale Irrig. Dist., 140 C. A. 141.

This fund is a trust fund, and must be devoted solely to payment of bond obligations in the manner specified in the Act.

Irrigation District Act, secs. 29, 52;
Bates v. McHenry, 123 C. A. 81;
Provident Land Corp. v. Zumwalt, 12 C. (2d) 378;
El Camino Irrig. Dist. v. El Camino Land Corp., 12 C. (2d) 791;
Carteret County v. Sovereign Courts, 78 F. (2d) 337.

The plan of composition seeks to perpetuate the unlawful act of the District in diverting these funds from the bondholders whose equitable property they are. There is no provision for the repayment thereof, and the plan

contemplates that the District shall keep the funds so appropriated by it, despite the fact that such funds are not the property of the district.

We have seen that the diversion of assets in a reorganization proceeding is such an act of bad faith as will bar any recovery by the petitioner.

Petitioner, having misappropriated trust funds belonging to its bondholders, without intention of restoration, which misappropriation is intended to be perpetuated by the plan of reorganization, is guilty of breach of trust, which is a complete bar to the relief sought by the petitioner herein.

3. The petitioner is barred from relief under the Act because it has unfairly and needlessly harassed, hindered, delayed *and defrauded its creditors.*

(1) We have just discussed the admitted fact that the petitioner, in violation of the rights of respondents, unlawfully diverted over $700,000 of bond funds to other uses. This had the necessary effect (and since it was intentional, the deliberate purpose), of hindering, delaying and defrauding its bondholders, driving down the market price of the bonds, and thereby stampeding bondholders into "accepting" the plan now sought to be enforced (which was first offered early in 1935), and thus creating an atmosphere of plausibility in which to advance the proposition that petitioner could pay only what the plan offers.

(2) Petitioner, in violation of the rights of its bondholders, arbitrarily refused to levy any taxes for the purpose of paying accrued interest and matured bonds of the district for the years 1933, 1934, 1935, 1936, 1937 and 1938. (R. 403.)

During the period from July 1, 1933, to the present time, as testified to by the district auditor, Mr. Neel, the "bond fund has been kept empty" (R. 413.) by diverting

any funds that were properly applicable thereto, and by omitting any levy in the years 1933, 1934, 1935, 1936, 1937 and 1938, for the payment of principal or interest on bonded indebtedness of the district. (R. 403.)

The average assessed value per acre of land within the district is $60.00 per acre, (R. 517) according to the testimony of Mr. Sargent, secretary of the petitioner. On this basis, the owner of an acre of land was entitled to receive four acre feet of water, that is, approximately 1,300,000 gallons of water, in the year 1933, for 60¢. (R. 517.) In the year 1934 when the rate was $1.70 per hundred, the price for the same amount of water was therefore $1.02, and in each of the years 1935, 1936, 1937 and 1938, when the rate was $3.00, the said four acre feet of water cost $1.80, or, according to the testimony of another of the petitioner's witnesses, Mr. Molmberg, averaged about $1.75 (R. 488, 490) for which $1.75 the landowners received the 1,300,000 gallons of water. This rate is cheaper than the rate referred to in the case of *Morris v. Gibson,* 30 Cal. App. (2d) 684, where the District Court of Appeal of the State of California confirmed a referee's finding, at page 690, that the rate of 50¢ per acre foot charged in that district was as low or lower than any rate charged for water in the State of California, whereas the Merced Irrigation District charged only 15¢ per acre foot in 1933, 25¢ in 1934, and 45¢ in each year since that time. This rate compares with the rates in 1929 in Banta-Carbona Irrigation District in San Joaquin County of $4.88 per *acre foot,* in Lindsay-Strathmore District of $21.97 per acre foot, $1.56 per acre foot in South San Joaquin, and $1.27 per acre foot in Turlock (bonds current, not refinanced). (R. 976.)

The result of this low rate has been that the delinquency of the Merced Irrigation District reached the point where, as shown by petitioner's exhibit No. 25 (R. 667) taxes delinquent for the year 1936 and 1937, as of November 1,

1938, were only $3,614.59 on a levy of $342,946.70, the delinquency as of a date sixteen months after the levy became delinquent being fractionally over 1%. The tax delinquency for the three years, 1935, 1936 and 1937, totals about $12,000 (R. 668), as of November 1, 1938, an original levies of over $900,000, an average delinquency for the three years as of November 1 1938, of approximately 1-1/13%.

The delinquency of the 1937-38 levy, as of the delinquent date of the last Monday in June, was 6.84%, a lesser delinquency on the delinquent date than had occurred at any time prior thereto as far back as the table goes (1928).

Hardly any tax district of any kind or character has such a low delinquency as Merced Irrigation District.

We have seen that hindering, delaying and defrauding creditors, is an effective bar to any relief by petitioner herein (supra p. 40).

4. Petitioner is barred from relief by reason of its bad faith in misrepresenting its financial condition to be more than two and one-half million dollars worse than it is in fact, even assuming petitioner's own contention that it owes the R. F. C. the face amount of the old bonds with interest thereon.

A. Petitioner, even on its own theory, falsely overstates its liabilities by at least $1,509,366. This is the sum of several inaccuracies.

(1) Even assuming petitioner's theory concerning its debt to the R. F. C., it overstated the amount of outstanding current liabilities for "Unpaid Matured Bond Interest Coupons" by the sum of $824,684 *which had already been paid* by petitioner to the Reconstruction Finance Corporation, and by the additional sum of $168,-582.00 which *had already been paid* depositing bondholders, on account of such liability.

For the purpose of showing its alleged insolvent condition, petitioner offered the evidence of its auditor that the matured unpaid interest coupons of petitioner totaled $5,194,925, (R. 400) and offered in evidence Exhibit No. 26, labeled "Balance Sheet" (R. 669) which petitioner's auditor testified he prepared (R. 406), and which he testified was a true statement of the financial condition of the petitioner as of November 1, 1938 (R. 425), assuming its original bond liability as outstanding. This balance sheet shows, as a current liability of petitioner, unpaid matured bond interest coupons in the amount of $5,076,185.

On cross-examination, however, petitioner's auditor admitted that over $800,000 ($824,684, R. 764) of interest paid to the Reconstruction Finance Corporation was included in the figure of $5,076,185.00 of matured bond interest coupon liability shown on the balance sheet. (R. 425.) On petitioner's theory that the bonds surrendered to the R. F. C. are actually owing to it, this amount was a payment on the interest coupons held by the R. F. C. (R. 568.) Petitioner's auditor admitted that *nowhere on the balance sheet (Exhibit No. 26)* was any credit shown for this payment to the Reconstruction Finance Corporation. (R. 425.)

Petitioner's auditor further testified that $168,582 was paid as interest to depositing bondholders, and that no effect was given in the balance sheet to that payment. (R. 426.) But here, as with the larger item just discussed, these bonds are still outstanding as the petitioner contends this was a payment on account of matured interest coupons.

Petitioner's auditor further admitted (R. 520) that crediting the interest paid the Reconstruction Finance Corporation and depositing bondholders as payment on matured bond coupons, the liability for matured bond coupons, assuming petitioner's theory as to the debt due

the R. F. C., was $4,082,919, instead of the $5,076,185, shown on the petitioner's balance sheet, Exhibit 26 (R. 520, Exhibit Z, R. 885.)

Thus petitioner, on its own theory, overstated its liability for unpaid matured bond interest coupons by the sum of $993,266.00 *which has been paid.*

(2) Assuming petitioner's own theory of its debt to the R. F. C., it overstated its liability for interest on matured registered coupons by the sum of $129,000, *which never was owed.*

Petitioner's balance sheet, Exhibit No. 26 (R. 669) shows a liability of $1,004,887.54 for accrued interest on registered bonds and coupons.

On cross-examination, petitioner's auditor testified that this item (misprinted $1,400,887.54 at R. 425, 426) included interest at 7% on all coupons on bonds held by Reconstruction Finance Corporation maturing subsequently to January 1, 1933, even though petitioner had paid some of the coupons in question. (R. 425, 426.) The amount of overstatement of the liability for accrued interest on matured coupons thus arising was, on cross-examination, calculated by petitioner's auditor as $129,100.00, making the amount due on this item $875,787.54 instead of $1,004,887.54. (R. 520, Exhibit Z, R. 887.)

(3) Petitioner, in its balance sheet, Exhibit No. 26, overstated its bond principal liability by $387,000.

The bond principal indebtedness of petitioner (assuming that the R. F. C. owns bonds held by it) was and is admittedly $16,190,000. In the balance sheet placed in evidence by petitioner, under the heading "Capital Liabilities—Bond Fund", *the entire amount of the bond issue,* $16,190,000.00 is shown as a liability. *In addition,* under the heading "Current Liabilities—Unpaid Matured Bonds" appears, *as an additional liability,* the sum of

$387,000.00 (R. 669.) The effect of this was to show a total bond liability of $16,578,000, when the true liability was $16,191,000 (Aff. of Stange, R. 247, Aff. of Murphy, R. 252), thus overstating the bond principal liability by $387,000.00 *which the district never did owe.*

The total of the foregoing overstatement of liabilities which the petitioner either *has paid* or *never did owe,* which appear on the balance sheet, which the district introduced to show its alleged insolvent financial condition, is the sum of the foregoing items, to-wit: *$1,509,366.*

B. Petitioner understated its assets by more than $1,000,000.

(1) Petitioner's balance sheet, Exhibit No. 26, does not contain as an asset a levy of approximately $340,000 made for the year 1938-39 (affidavit of Mr. Stange, Item 5, R. 250, 251; Affidavit of Mr. Neel, R. 260), despite the fact that such levy was a lien on the first Monday in March of 1938. (Irrigation District Act, Section 40.) The levy was made in September of 1938 (affidavit of Mr. Sargent, R. 260), the levy was payable on or before November 1, 1938 (Irrigation District Act, Section 41), and became delinquent on the last Monday in December, 1938. (Irrigation District Act, Sec. 41.) Obviously, when the amount of the levy was determined in September of 1938, and a lien already existed in favor of the district upon all the lands within the district for the collection of the levy, it became an asset ascertained in amount immediately, and being due and owing not later than November 1st under the Irrigation District Act, was a current, matured account receivable on November 1st.

(2) There is also omitted from the assets shown on the balance sheet the net value of certain Crocker-Huffman water rights, approximately $840,000.

As testified by Mr. Sargent, Secretary of the District, the District took over the property and water rights in

the Crocker-Huffman Land and Water Company and assumed the obligation of encumbrances against the system, including obligations to deliver water at very low prices to its customers. (R. 510.) Subsequently the rights of said customers to receive water at these low prices were purchased by petitioner, under a contract with the customers providing for the payment of $60,000 a year for seventeen years, or a total of $1,020,000. (R. 512.) Of this sum, $180,000.00 remains unpaid, leaving the net amount paid at $840,000.00. The payments to acquire these rights were, of course, capital expenditures, and this fact was admitted by Mr. Sargent, secretary of petitioner, on cross-examination, to be a capital expenditure. (R. 515.) But the payment for these rights was charged to "Operation and Maintenance" rather than "Capital Expenditure." (R. 515.)

There is no doubt that petitioner's secretary was correct in making this admission. Obviously the price paid the Crocker-Huffman Land and Water Company for its properties was arrived at after deducting an amount sufficient to cover the liability on the customers' contracts thus assumed, from the value of the properties purchased.

In other words, the price paid for the Crocker-Huffman system was the $2,250,000 paid the Crocker-Huffman Land and Water Company, plus the $1,020,000 agreed to be paid its customers for their contracts, totaling $3,270,000, of which $180,000 still remains unpaid. The fact that these contracts are to be paid in full demonstrates the actual value of the asset. (R. 511, 512.) Of this amount, only $2,250,000 is treated as an asset by the petitioner, the rest being admittedly improperly charged to expense.

Thus it appears beyond question that the petitioner has omitted from its statement of assets the $840,000 in question.

(3) The petitioner also has paid annually from $10,000 to $11,000 on the bonds of three Drainage Districts, charging them to "Operation and Maintenance" account instead of "Capital Expenditures." (R. 515.)

These three drainage districts, formed before the irrigation district, were taken over by the district, and their bonds assumed and paid by the district. (R. 514.)

Failure to show the aggregate of these payments as a capital asset was obviously improper for the reasons just discussed. Hence, all of the current tax liability to the District, amounting to approximately $340,000, plus the equity of the District in the Crocker-Huffman contracts in the amount of $840,000, plus the value of the Drainage District Works which the District has taken over, have been omitted from the statement of assets shown on the balance sheet of the petitioner.

C. Even on its own theory, the petitioner overstated the alleged deficit in its bond fund by at least two million dollars.

(1) The petitioner's balance sheet (Exhibit No. 26, R. 669) shows the purported totals of its liabilities for (a) unpaid matured bond interest coupons, (b) unpaid matured bonds, and (c) accrued interest on registered bonds and coupons, and over against the sum of these accounts, states the amount of its cash in the bond interest and principal fund, thus showing a deficit in the bond fund surplus (old) account of $6,466,862.74 (red). (Red not indicated in Record.)

The account termed "bond fund surplus (old)" is so designated to indicate that it relates only to the original $16,190,000 bond issue, and to distinguish it from accounts relating to the refunding loan from the R. F. C.

We have already shown that the unpaid matured bond interest coupon liability is $993,266 *less than* that stated

on the balance sheet. This in fact reduces the bond fund deficit by the same amount, on petitioner's own theory.

Similarly, the fact that the accrued interest on registered bonds and coupons is $129,100 less than that stated on the balance sheet, reduces the bond fund deficit by that further amount.

Similarly, the fact that the unpaid matured bonds in the sum of $387,000 were written up as an additional liability in addition to the entire principal amount of the original bond issue of $16,191,000 reduces the bond fund deficit by that additional amount.

The total of the foregoing deductions that must be made from the bond surplus account deficit as shown by petitioner is *$1,509,366,* all arising from an overstatement of the bond liability, on petitioner's own theory.

(2) In addition to the foregoing errors arising from overstatements of bond liability, $717,932.50 was, as we have seen, admittedly diverted from the bond fund to the general fund.

Since this fund is a trust fund, and the district, as we have seen cannot lawfully remove such funds therefrom, this money, (which is still an asset but held in other funds), is an asset of the bond fund which the district is required to retransfer thereto. *(Selby v. Oakdale Irrig. Dist.)* and accordingly reduces the purported bond deficit by an additional $717,932.50.

On petitioner's own theory, therefore, the aggregate total of the overstatements of bond fund deficit by reason of setting up liabilities that do not exist, in the sum of $1,509,366, and by reason of the diversion of the trust fund of $717,937.50, is *$2,235,869.*

D. The net effect of the foregoing overstatements of liability and understatements of assets is that petitioner overstates its purported total net deficit by more than two and one-half million dollars on its own theory.

(1) The net deficit indicated by petitioner's Exhibit 26 is $2,282,721.21. On the balance sheet which petitioner offers in evidence, Exhibit 26, there is no concise statement of the amount of net worth of the petitioner. The assets are shown, liabilities are shown, but the net worth must be found by adding up the several surplus and capital account figures, and subtracting therefrom the red or deficit surplus account figures. (R. 426, 520.)

The bond surplus (old) account, deficit, printed on the original balance sheet in red (but without an indication in the record that such is the case) of $6,466,862.74, must be offset by the sum of the capital surplus fund, the refunding bond interest surplus, the refunding reserve surplus, and the general fund surplus, aggregating $4,484,-141.53, in order to obtain the net worth of petitioner as shown by the balance sheet. (R. 426 and 520, Exhibit 26, page 669.) The net worth of petitioner thus arrived at is a deficit of $2,282,721.21.

(2) The net deficit of $2,282,721.21, indicated by petitioner's balance sheet, Exhibit No. 26, is in error by the overstatement of the liabilities of the petitioner in the sum of $1,509,366.

Under cross-examination of the District's auditor, he testified (R. 520) that Exhibit "Z" correctly sets forth the *actual* net deficit after correcting the overstatement of bond liability in petitioner's Exhibit 26. (Exhibit "Z", R. 885 and 887.) This shows the capital surplus deficit to be $773,355.21 in place of $2,282,721.21 as indicated by Exhibit 26, arising from the overstatement of bond liability in the sum of $1,509,366.

(3) The net deficit indicated by petitioner's Exhibit 26 is overstated by the amount of assets not set forth on petitioner's balance sheet, in the sum of $1,180,000.

It has been shown that the District entirely omitted from its balance sheet current taxes receivable in the sum of $340,000 as an asset, and that it also omitted the value of the Crocker-Huffman water contracts, the net value of which was $840,000, as well as the value of the Drainage District Works, the exact amount of which is unknown. These assets totaled more than $1,180,000. The assets thus omitted must be added to the capital surplus account as shown on the balance sheet.

The deficit having been reduced to $773,355.21 by omitting the non-existent liabilities, the addition of $1,180,-000 additional assets to the surplus account changes the *net deficit* indicated on petitioner's balance sheet, of *$2,282,721.21,* to a *capital surplus* of at least *$406,644.79.*

(4) Petitioner maintained books and records on two separate theories of its liabilities to the R. F. C., only the one showing the maximum liability being presented to the Court.

Exhibit 26 was presented by petitioner on the theory that, by the advances made by the R. F. C., the R. F. C. became creditor to the full extent of the original bond liability, instead of by the amount of the advances.

At the same time, petitioner submitted reports and *balance sheets* to the R. F. C. semi-annually, showing as the indebtedness of petitioner to R. F. C. only the amount of the latter's advances, amounting to about $7,500,000 (Exhibits J and K, R. 774, 784.) The existence of these reports and balance sheets was discovered by appellant's counsel on an inspection of petitioner's records just prior to trial under court order (R. 143) and they were introduced into evidence by appellants.

Appellants also offered in evidence Exhibits A, (R. 755); E, (R. 764); L, (R. 791); N, (R. 796); among others, showing that the petitioner's own records, and those of the R. F. C., showed the debt from petitioner to R. F. C. to be only the amount of advances made.

Appellants further proved by petitioner's auditor that the books of petitioner were set up allocating funds for the repayment of the loan advances by the R. F. C. (R. 369-370.)

A comparison of the balance sheet of petitioner presented to the Court, Exhibit 26, and the balance sheets presented to the R. F. C., Exhibits J and K, shows that the balance sheet presented to the Court alleges liabilities over $13,000,000 greater than the balance sheets presented to the R. F. C.

The making of erroneous statements as to financial condition bars petitioner from the relief sought in this proceeding.

1. The making or uttering of an untrue balance sheet or financial statement is made unlawful by the Statutes of California, Penal Code, Sections 532a, 563 and 564.

2. The making of a false account in relation to any proceeding under the Bankruptcy Act is prohibited by Section 29, subsection b (paragraph 2) of the Bankruptcy Act.

3. The giving of any false information concerning the financial condition of a petitioner in reorganization proceedings, regardless of motive, is a bar to granting petitioner any relief under the Bankruptcy Act.

In re Wisun & Golub, Inc., 84 Fed. (2d) 1 (C.C.A. 2);

In re Slocum (C.C.A. 2) 22 Fed. (2d) 283;

Shanburg v. Soltzman, 69 Fed. (2d) 262.

In the case of *In re Wisun & Golub* the District Court confirmed a plan of reorganization approved by an overwhelming majority of the creditors, although the referee had found, after an audit of the books and records, that petitioner had not accounted for some six hundred dresses.

The Circuit Court of Appeals reversed the District Court upon the ground that, although the evidence did not show that such failure to account was intentional, the shortage existed and that fact was such an act of bad faith as to bar the petitioner from any relief under the act, the Court saying (p. 3):

> "As a condition preceding approval by the court of a petition as properly filed, it must be found to have been filed in good faith. The master's finding of concealment of the dresses is a *fatal objection* to approval of the petition. A debtor who hides his assets from his creditors and attempts to reorganize its business without disclosure of such assets to his creditors, deals unfairly with them. He attempts to cheat them by withholding property which is theirs for the payment of his indebtedness. To attempt such a fraud is bad faith. 'Equity will not aid those who defraud or deceive.' See In re Knickerbocker Hotel Co., 81 F. (2d) 981 (C.C.A. 7.) Such conduct inspires no confidence and contradicts any avowal of an honest intention to effect a reorganization which should be for the benefit of creditors as much as for the stockholders of the corporation.
>
> The petition should have been refused."

In this case, in place of omitting to account for some six hundred dresses, petitioner omitted to account for a rather substantial amount of assets. Furthermore, petitioner erroneously set up as liabilities a very substantial amount which it never had owed or had paid. Petitioner set up a deficit of a rather substantial amount when in fact petitioner had a surplus. These errors were on the theories most favorable to the petitioner.

It is not necessary to consider the intention of the District in making these errors. The law provides that the making of the errors *ipso facto* constitutes a bar to relief.

It is respectfully submitted that the petitioner is not entitled to relief in this proceeding, by reason of its errors in overstating the amount of its liabilities, and alleged deficit, and understating the amount of its assets.

5. The District's proposal of a plan reducing creditors' claims by half, when all it needs is extension of time, is itself bad faith, under the authorities.

We later show that the district is abundantly able to pay its debts and its need is only for an extension of time owing to temporary absence of funds.

Under the authority of Section 11 of the Districts Securities Commission Act (Appendix p. i) the district has since 1933 levied only such assessments as it has determined, with the Commission's approval that it could pay. (Ex. OO, p. 98.) (R. 711.) Thus the district presently has all the relief it needs.

If as we contend the district has not sustained the burden of proving that it cannot ultimately pay all its debts in full, its attempt to reduce the claims of its creditors by one-half is itself an act of bad faith, under the authorities cited above.

THIRD PROPOSITION: PETITIONER HEREIN IS NOT "INSOLVENT OR UNABLE TO MEET ITS DEBTS AS THEY MATURE".

Assignment of Error No. 14 reads,

> "The Merced Irrigation District, at the time of the filing of its petition was not and is not insolvent, nor unable to pay its debts as they mature." (R. 284.)

Petitioner, apart from a tremendous amount of other assets and revenue, has *cash on hand* sufficient to pay all matured liabilities, and has *power revenue* alone more than sufficient to pay all future obligations as they mature.

As we have shown elsewhere (supra), the liability of the district to the R. F. C. is the amount of the advances made by the R. F. C. to petitioner.

Regardless of the determination of the Court as to whether the R. F. C. is entitled to consent to the plan herein, or to be considered as a creditor of the same class as other bondholders, in considering the question of the solvency of petitioner only *the actual amount which petitioner is required to pay* can be considered as the amount of its liability.

In a bankruptcy proceeding, a creditor who advances money and obtains as security obligations of the debtor greater in amount than the amount of the advances has a claim in bankruptcy only to the extent of the advances.

Jones v. Third National Bank, 13 Fed. (2d) 86;
Union National Bank v. Peoples Trust Co., 28 Fed. (2d) 326.

See also:

Anglo-California Trust Company v. Oakland Railways, 193 Cal. 451 at 466;
Borland v. Nevada Bank of San Francisco, 99 Cal. 89.

The solvency or insolvency of the Merced Irrigation District must be determined as of the date of the filing of the petition herein in May of 1938.

In re Hansen Bakeries, 103 Fed. (2d) 665.

The financial condition of the petitioner arising from the consummation of the contract between the petitioner and the R. F. C. is disclosed in the reports and balance sheets

of the petitioner rendered to the R. F. C. as of December 1, 1937 (Exhibit J, R. 774) and as of July 1, 1938. (Exhibit K, R. 784.)

A reference to said Exhibits J and K and to Exhibit AA (R. 887), a condensed statement bringing these balance sheets to the date of the trial (R. 524), shows a surplus of assets over liabilities of well over $10,000,000. All obligations to the R. F. C. and to all other creditors save appellants are current. There is owing to outstanding bondholders matured interest coupons as of July 1, 1938 in the sum of $496,542.50 and interest on registered bonds and coupons in the sum of $70,459 (R. 788, note on balance sheet), making total interest due $567,001.50. In addition, a part of the matured bonds of the district, which total $387,000 (R. 669), most of which matured bonds are held by R. F. C., is held by outstanding bondholders. The total past due liability to outstanding bondholders is not over $650,000. Cash on hand amounted to $1,578,446.14. (R. 887.)

Thus, after paying all matured obligations from cash on hand, petitioner would still have $800,000 cash on hand.

As we have pointed out elsewhere in this brief (infra) the petitioner's *power revenue* alone is more than sufficient to pay principal and interest maturities on the remainder of its debt.

FOURTH PROPOSITION: THE PLAN OF COMPOSITION IS NOT FAIR, EQUITABLE OR FOR THE BEST INTERESTS OF THE CREDITORS, AND IT IS DISCRIMINATORY.

Assignment of Error No. 9 reads:

> "The plan of composition herein is unfair, inequitable, and unjust and is not for the best interests of the creditors and it discriminates unfairly in favor of the Reconstruction Finance Corporation." (R. 284.)

We will discuss this point entirely on the assumption that the petitioner owes to the R. F. C. the entire principal amount of its bonds, with accrued interest, as it claims.

A. The plan of composition is discriminatory in the following respects:

(1) Assuming that the R. F. C. is a creditor of the same standing as the appellants, the plan is unfair because it offers a 4% bond to the R. F. C., but denies a like privilege to the appellants;

(2) The plan discriminates in favor of the R. F. C. as a creditor because it has allowed to it interest at 4% per annum on the basic figure of 51.501¢ on the dollar ever since October 4, 1935. The district has actually paid to the R. F. C. up to and including July 1, 1939 interest payments in the sum of $1,127,485. (R. 402.) Appellants are not offered any interest whatever.

(3) The plan is discriminatory because it allowed to bondholders who deposited their bonds on or before October 4, 1935, 4% interest from date of deposit to that date. The amount so paid to them by the district was $168,027.31. (R. 763.) No compensation is allowed by the plan to appellants for the period they have waited, although during most of this time there was no statute in effect under which this district could have compelled acceptance of its plan.

In the case of *In re James Irrigation District,* 25 Fed. Supp. 974 at 975, it was held that interest paid to consenting creditors should also be paid to non-consenting creditors.

Appellants should not be penalized for resisting the prior proceeding, which was determined to be void as they contended. Delayed payment is vitally different from prompt payment:

State v. City of New Orleans, 102 U. S. 203.

The plan in that case was approved subject to such provision being made.

(4) The plan is unfair because it permits the payment in full of bonds of other taxing agencies which are in effect liens against the same territory without requiring any corresponding reduction. (R. 955, 957, 959.) In fact, these overlapping bonds have all been paid in full as to all maturities (R. 540), and 5% bonds of one of them at least, the Merced Union High School District, are selling at 101. (R. 521.)

(5) The plan is unfair because it violates the principle of the *Boyd* case, cited elsewhere in this brief, in that it in effect takes property from the bondholder and gives it to a junior encumbrancer, the holder of mortgages and deeds of trust, and to the stockholder, so to speak, viz., the landowner. (*Tellier v. Franks Ldry. Co.,* 101 Fed. (2d) 561.)

B. The plan is unfair, inequitable and not for best interests of creditors.

A plan must give to creditors everything of value to which he is entitled, and can not take from him for the benefit of junior lien-holders or debtors any valuable right or property.

(1) The plan is unfair because it takes *trust funds and properties* belonging to the appellants from them as elsewhere in this brief more particularly shown;

(2) Based on the report of Dr. Benedict (Petitioner's Ex. 35), and a study of computations from the books of the district, it has been determined that as of the year 1936 when the computation was made, the capital loss to the appellants on their investment is 53.3%, by which the landowner would benefit only to the extent of 7.4% on his yearly operating costs. (R. 548, 974.) This means that the senior creditor must give up over 53% of

his investment in order to benefit the landowner to the extent of 7.4% on his yearly operating costs. This contribution is inequitable, and the slight margin of saving of 7.4% on the operating costs of the farmer in the district cannot well be the decisive factor in making his project a paying project;

(3) One of the questions which no man of finance, no banker, no economist, no judge can answer today is whether or not this country is faced with inflation. The very inability to determine this question is the one having the greatest influence upon investments at the present time. If inflation comes, the debt of this district, whether it be $8,000,000 or $16,000,000, will be an inconsiderable factor in its future welfare, because, even a minor degree of inflation would enable the district to liquidate its debts fully with comparative ease. A plan, therefore, which now determines in effect that there will be no inflation, but, on the contrary probable deflation, is inequitable;

(4) The plan is unfair because but few bonds owned by the appellants have matured and many of them will not mature until the 1950's and 1960's and it is utterly impossible and wholly unnecessary for the Court to determine now what the future holds twenty years hence. The bonds in question are not callable, and the appellants are not asking that they be paid before their maturity. The sudden change in prices of many commodities owing to the second world war in Europe is a factor which the Court could not have anticipated and is but an illustration of the impossibility of determining whether it is fair to pay off an obligation due in twenty years at 50¢ on the dollar now;

(5) The plan is unfair because under California statutes, 1917, page 243, as amended, the district Securities Commission was required to, and did in its order No. 54 (R. 949) determine that the value of the unimproved

land in the District plus the water rights and other works of the district exceeded by at least 40% in value the amount of the second refunding bond issue, that is to say, the amount of the loan from the R. F. C.;

(6) The plan is unfair because the district Securities Commission had only shortly prior to its order No. 54 determined that the district could pay a first refunding bond issue which was for the full amount of the principal of the original bonded debt of over $16,000,000 and that this amount was not over 60% of the value of the bare land and works of the district (R. 497);

(7) The plan is unfair because, even assuming its own theory of the amount of its debts, petitioner has assets far exceeding its liabilities.

The assets of the district disclosed by its balance sheet (Ex. No. 26, R. 669) are the sum of $20,478,901.26.

As we have seen, this figure omitted assets in the sum of at least $1,180,000, being $340,000 of current assessments receivable, and $840,000 equity value of the Crocker-Huffman contracts purchased by the district. Thus total actual physical assets of petitioner exceed $21,600,000, according to its own proof.

The liabilities claimed by petitioner are $6,470,622.47 current liabilities, and $16,191,000 bond liabilities, totaling $22,761,622.47. (R. 669.) We have seen that this figure overstated liabilities by including $1,500,000 of liabilities which had either never accrued or had been paid, thus reducing the liabilities to about $21,200,000. Thus, the undisputed evidence shows petitioner has a surplus of over $400,000.

In addition the district has as an asset the taxing power. Appellant's bonds are general obligation bonds.

Roberts v. Richland Irrig. Dist., 289 U. S. 21, 53 Sup. Ct. 519;

Judith Basin v. Malott, 73 Fed. (2d) 142;

Rohwer v. Gibson, 126 Cal. App. 707;
Bates v. McHenry, 123 Cal. App. 81;
Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365.

The value of the taxing power as *an asset of the Merced Irrigation District* is so great as, together with the fair value of its other assets, to make the petitioning district overwhelmingly solvent.

Up to about 1932 the assessed value of the lands within the district was set at about $20,000,000, at which time there was a material reduction in assessed value resulting in reducing the assessed value of the district to between eleven and twelve million dollars. (R. 424-425.) Only the land is assessed and not improvements. The assessed value of agricultural land within the district averages $60 per acre. (R. 517.) The average value of land within the district according to the undisputed testimony of petitioner's own witness Momberg is about $135 per acre ($450,000 for 3500 acres). (R. 485.) This was for property that was fairly representative of all the properties within the petitioning district. (R. 473.) The ratio of $60 of assessed value to $135 of actual sales price (petitioner having made 67 actual sales (R. 489), is a ratio indicating that the fair market value is about two and one-fourth times the assessed value.

According to the report of the California State Board of Equalization for 1933 and 1934, the total assessment for taxation of property in Merced County was approximately 35 per cent of its actual value (R. 960) so that according to this report the ratio of actual value to assessed value for the year 1933-1934 was about 2⅚ to 1.

Assuming the lower ratio testified to by Mr. Momberg, the fair market value of the land, *exclusive of improvements,* within the Merced Irrigation District is therefore two and one-fourth times the assessed value of $11,400,000, or at least $25,000,000. The market value of this

land, of course, represents the *equity of the owners of the land* after considering the probable charges for bond service, etc., and for irrigation district operations.

Moreover, the cities of Merced County, practically all of which are in the district, had a property valuation of $21,452,455 (R. 960) in 1929-30, apparently exclusive of operative properties of Public Utilities, which had an assessed value, in the county, in 1935, of nearly $8,000,000.

Certainly a valuation of $25,000,000 on the taxing power of the Merced Irrigation District would be extremely conservative in the light of this undisputed testimony.

Therefore, there must be added to the assets admittedly held by the irrigation district the sum of $25,000,000, which brings the total assets of the district to something over $47,000,000, as against claimed liabilities of about $21,200,000—clearly an overwhelming excess of assets over liabilities, showing solvency clearly.

(8) We now turn to another great money asset of the district. It is the power produced at Exchequer Dam.

If the district is successful in reducing its bond obligation to $8,600,000, as provided for in the plan involved in these proceedings, then to all intents and purposes, from that day on, Merced Irrigation District will be entirely debt free. That condition will be accomplished by taking from the bondholders approximately one-half of their investments.

The district is the owner of a power plant at Exchequer Dam. (Respondent's Ex. "RR", p. 118, Ex. "OO".)

All the power to be produced at this power plant has already been sold on a long term contract. (Respondent's Ex. "EE", R. 945.) It is stipulated that the power contract has been sustained by Court action. (R. 538.)

We now turn to the testimony of Heinze and Hill. The testimony of these two witnesses commences at page 524 of the record. These witnesses are experts of the highest order. Mr. Heinze made a thorough study of the record of the Merced River and based his conclusions upon that record, the actual experience of Merced Irrigation District over the years of its operation, the contract for the sale of the power, including preferential for irrigation purposes, etc. Over the past thirty-four years from the time of his testimony upon what is known as the straight line method of depreciation, had the power plant been in operation all that time, the district would have received an average annual net of $456,058 from its power sales, and if figured on what is known as the 5% sinking fund method of depreciation, and which the witness stated is the common practice before the California Railroad Commission, the average net income which the district would have received over the thirty-four year period would have been $467,932.

If the district succeeds in this proceeding its total bond debt will be $8,600,000 represented by refunding bonds at 4% to be held by R. F. C. and payable over a period of forty years. The witness stated (R. 529) that the amount of $434,300 each year would completely amortize the $8,600,000 bond issue at 4% over a period of forty years. In other words, the new debt of the district would be completely amortized by its sale of power alone based upon its present method of depreciation with something like $22,000 each year left over, and if placed on a 5% sinking fund method of depreciation the district would have left over each year approximately $33,000 on the average.

Put it another way: If the district will simply take its net power revenue over the period of the new refunding bonds that will be delivered to R. F. C. and place

all of that net power revenue in the bond fund, that revenue will considerably more than completely amortize the R. F. C. loan within the life of the bonds. That is why we say that the district will in effect, be entirely debt free, as it will not be necessary for the district to ever levy one penny piece upon the land for bond service, and yet the present bondholder is asked to give up approximately one-half of his investment in order to bring about that very happy condition for the district.

The above testimony of Mr. Heinze was given at the first trial in the United States District Court. Prior to the trial upon which this appeal is made, Mr. Heinze brought his studies down to date and those new studies are represented by Respondent's Exhibit "DD-1" (R. 933) which is still more favorable to the district as two or three rather high years of run-off from the Merced River had intervened. The original studies were made at the end of a very dry period.

Mr. Louis C. Hill (R. 533) confirmed Mr. Heinze but carried his study back 64 years. Both witnesses agreed, which is obvious, that the longer the study the more accurate would be the result. He arrived at a gross annual figure of $533,987, as against a gross return by Mr. Heinze of $500,415. (R. 526.) Mr. Hill stated (R. 538) that by the district adding $32,489 to its average net power return it could completely pay off its new proposed bond issue of $8,600,000 at 4% interest, in thirty years. And yet it is claimed that this plan is fair. These witnesses are not impeached. They are not contradicted. These two engineers are of outstanding ability. Heinze is an electrical engineer of wide experience. Mr. Hill (deceased since his testimony was given) was an engineer of national standing. Of course their figures are estimates, and obviously would not be 100% accurate, but they are

reasonably accurate so far as past records are concerned, one for 34 years and the other for 64 years. As said by Mr. Hill (R. 535) "It is my opinion that looking to the future some 30 or 40 years, the District could reasonably expect the figures to approximate the average figure for the 64 years". Now there is a sufficient leeway between the amount necessary to amortize the new proposed bond issue and the amount of net revenue that the district could reasonably expect to receive from its power sales, so that it may be taken as an established fact that the district will receive an average amount of net income from its power sales to completely amortize the new proposed bond issue without ever being required to levy a single penny upon the land for bond service.

It is readily recognized that there will be high power income years and low power income years. That cannot matter. The average for the future will no doubt be very nearly what it would have been in the past and we know what those years would have produced. Furthermore the above computation is based upon the contract which will expire in 1964, some ten years before the last of the refunding bonds will mature; but that is quite immaterial for two reasons. First, it may be presumed that the price of power after 1964 will not be materially different. There is no evidence upon the subject. Second, the district is setting up a depreciation so that the plant may be entirely rebuilt at a given time. In other words, in 1964 the district will own, in effect, if not actually, a brand new plant, entirely paid for, of a value several or many times the amount of the then unpaid refunding bonds. A net income of more than $400,000 capitalized produces a very large figure. It will be remembered that this power plant is being depreciated so that long after all present debts are paid, the district will still be the owner of this valuable asset.

(9) The reasonable income capacity of the petitioner district is sufficient to pay off its debt in full, on petitioner's own theory.

As we have seen, petitioner has for six years levied a very low tax under Section 11 of the Districts Securities Commission Act. (Appendix, p. i.) On our theory of the R. F. C. debt, this was not particularly harmful, since petitioner has more than twice as much cash on hand as is necessary to pay all matured obligations. On petitioner's theory, however, the result of this action was to accumulate matured unpaid bond coupons of $4,-082,919, $875,787.54 interest on registered bonds and coupons, and $387,000 matured principal, totaling $5,345,706.54 matured bond liability (R. 886) against which should be credited cash on hand totaling more than $1,500,000, leaving a net past due maturity to be paid from other sources of about $3,900,000.

While this debt is not due until collections are made for payment, as determined in *Moody v. Provident Irrigation Dist.,* supra, and under the provisions of Section 11 of the Districts Securities Commission Act, it would be preferable to refund the entire debt of the district on a more scientific basis.

The total debt to be refunded, on petitioner's theory, matured and unmatured, is slightly less than $20,000,000. In accordance with modern financing practice this debt, being for improvements of a permanent nature, not subject to heavy depreciation, should be repaid over a fifty-year period in equal semi-annual installments, including both principal and interest. The interest rate would not exceed 5%, and the annual debt service on that basis would be $1,092,476. (*Montgomery's Financial Handbook* (2 ed.), pp. 1417, 1422.) It is apparent that taking account of power revenue, and the wealth of the district generally, this amount could be carried without distress.

And under the modification of petitioner's plan proposed by appellants, petitioner's financial burdens would be much less. That proposed modification (R. 164), was that the rate of interest on petitioner's bonds be reduced to 3% from the date of default in payment of interest (July, 1933) to maturity.

Assuming petitioner's theory that all of the bonds are still owing, this would reduce the amount of interest now overdue (still assuming all of the bonds are owing), by a saving of $1,792,395; and would reduce interest charges from the present time on, so as to effect a saving of $465,200 per year from the present time until payment of principal. The annual saving in the future will of course be reduced as the principal sum is reduced.

(10) *Merced Irrigation District comprises a fertile and good section of the State.*

The Court will take judicial notice of many of the important features of this great district. The Court knows judicially that this governmental agent of the State occupies a large area near the geographical center of the great San Joaquin Valley, and of the general soil, water and climatic conditions. (*Greeson, et al. v. Imperial Irrigation District, et al.*, 59 Fed. (2d) 529.)

Respondent's Exhibit "RR" found at page 118 of Exhibit "OO" which is volume 4 of the transcript, states that the district is the fifth largest district in California, and one of the most important and has a gross area of slightly more than 189,000 acres, and is located on two main line railways and two branch railways, and indicates that the district has a good water right with ample storage and a power resource of very great value.

Mr. Covell testified (R. 543-546): that for many years he had been entirely familiar with the lands in Merced Irrigation District and similar areas at other places in

the State and indicated further that he knew the general situation very well and indicated that the lands in Merced Irrigation District compare quite favorably with other good sections of California.

Adverting again to Respondent's Exhibit "RR" commencing at page 118 of volume 4 of the transcript, it is stated that the soils are mostly of the Fresno, Madera and San Joaquin series.

Turning to Respondent's Exhibit "AAA" we find excerpts from the United States Department of Agriculture, Bureau of Soils (Tr. p. 987) where it is indicated that Madera loam ranks among the best soils of the survey, and that Oakley and Fresno sands rank among the most important of the survey for intensive crops, etc.

Respondent's Exhibit "XX" consists of excerpts from Bulletin 21a of the State Department of Public Works. (R. 975-978.) This table reports on 69 irrigation districts in California, and indicates that there were 39 districts with higher water costs per acre in 1929 than Merced, and there were 45 irrigation districts with a higher water cost per acre foot than Merced.

Respondent's Exhibit "ZZ" (R. 979-985) indicates, first, that this district has a very large and dependable storage supply of water.

Table II of Respondent's Exhibit "ZZ" is a crop report for 1934, and shows Merced to be one of the most fully diversified of any of the districts in California.

Table V of said Exhibit "ZZ" shows some 16 irrigation districts in California with a higher irrigable acre bond debt than Merced, and that of course is not counting the power resources. Without trying to compute it to any nicety, it would appear that if the power asset of Merced Irrigation District were capitalized and applied against

the bonds as originally outstanding, there would be something like thirty irrigation districts with higher per irrigable acre bond debt than Merced.

In considering a comparison between Merced and other comparable districts, such as the outstanding Turlock Irrigation District, it will be kept in mind that the costs above referred to in Merced District include delivery to each 160 acres of land, whereas in some other district such as Turlock, delivery is made only in the laterals and the farmer must pay the additional cost of taking the water to his land. (Bottom p. 130, Benedict Report, Petitioner's Ex. No. 35, set out in separate volumes.) From the evidence it is indicated that Merced Irrigation District is one of the better agricultural communities of the State. It has good soil. It has good transportation facilities. It is admirably located. It has one of the best water supplies in California. It produces diversified crops. Its obligations are not materially higher than others. In other words, it is a good agricultural community and is not in need of charity from its bondholders or others.

(11) No attempt was made by the district to meet the contention that its financial condition on June 17, 1938 (the date of the filing of the petition herein) was entirely different from its financial condition on April 19, 1935, the date of the filing of the prior petition. The two plans are identical in all respects. Appellants' Exhibit A (R. 852), shows that the cash balance in all funds of the district on December 31, 1934 was $346,313.61. Exhibit 26 shows that the cash in the funds of the district on November 1, 1938, was $1,578,446.14. (R. 669.)

FIFTH PROPOSITION: THE CLAIMS WERE IMPROPERLY CLASSIFIED AS BEING ALL OF THE SAME CLASS.

Assignment of Error No. 19 reads

> "The Court ered in classifying the creditors, including the Reconstruction Finance Corporation, as one class." (R. 285.)

The Judge erroneously classified all of the claims as of the same class. Section 83(b) provides,

> "The holders of claims for the payment of which specific property or revenue are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors."

In *In re James Irrigation District,* 25 Fed. Supp. 974, which case was decided simultaneously with the instant case, the Court held that where the fund is earmarked and limited, it must be prorated among all bondholders.

Section 52 of the California Irrigation District Act expressly provides that upon presentation of a matured bond or coupon to the Treasurer for payment he shall pay the same from the bond funds.

The leading case in California construing this provision is *Bates v. McHenry,* 123 C. A. 81, which was a case involving the Merced Irrigation District. Bates brought suit to compel payment of interest coupons at a time when there were not funds sufficient to pay all the matured interest coupons. The Court directly held that it was the duty of the Treasurer to do two things:

> "He must either pay the bond or interest coupon when presented or register the same. The irrigation laws do not confer upon the Treasurer of the District any authority to prorate payments."

It is to be observed that at the time this opinion was rendered there was on hand insufficient funds to pay all the interest due.

This case and its doctrine has been followed by all Courts in California ever since. The decisions which affirm the doctrine there stated are: *Selby v. Oakdale Irrigation District,* 140 C. A. 171; *Morris v. Gibson,* 88 C. A. D. 703; 89 C. A. D. 140; *Shouse v. Quinley,* 3 Cal. (2d) 357; *Rohwer v. Gibson,* 126 C. A. 707; *Strasburger v. Van Derlinder,* 17 C. A. (2d) 437, and most recently *El Camino Irrigation District v. El Camino Land Corporation,* 96 C. D. 505, and *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365. The two cases last mentioned involved admittedly insolvent irrigation districts *which no longer had even a theoretical inexhaustible* taxing power, for the bulk of the lands within these districts were already owned by the districts themselves through tax title process, the Court saying in the last-mentioned case:

> "The delinquencies have gone too far in this and other districts to save the landowners."

These two last-mentioned decisions reaffirm the principle of payment of matured bonds and coupons in the order of their presentation to the Treasurer for payment despite insolvency.

It is therefore apparent that within the meaning of the words of Chapter 9 "preference as provided by law" those bondholders who hold matured bonds or matured coupons which have been presented to the Treasurer for payment have been given a preference by law, which preference must be recognized by the bankruptcy court in classifying creditors.

Each matured bond and coupon when presented for payment becomes "a separate class."

Now the District Judge laid aside this principle of priority, clearly established by California decisions, in favor of the principle of prorating payments which was alluded to in the *Kerr Glass Case,—Kerr Glass Mfg. Co. v. City of Buenaventura,* 62 Pac. (2d) 583, 7 Cal. (2d) 701. This was error.

The Facts Applicable.

All the appellants made and filed proofs of claims, and answers in the proceedings. (R. 341.) The claims and answers of substantially all of the appellants show their ownership of matured bonds and coupons and presentation of the same to the Treasurer for payment, for example, the answer of Morris (R. 103) and the answer of Bekins et al. (R. 116), West Coast Life Ins. Co. (R. 108.) The stipulation of the parties (R. 144) provided that such claims could be shown by answer or by claim and the stipulation (R. 542) admits ownership. The fact of presentation for payment is shown at R. 400.

On the other hand, although it was shown (R. 349) that bonds purportedly held by the R. F. C. have been registered in their name, there is, as has been repeatedly stated, no claim of the R. F. C. on file in these proceedings.

Whatever may be the actual order of presentation of matured bonds and coupons to the Treasurer for payment under Section 52, this much is clear, that under California law a *preference by law* is given thereby and the bankruptcy court can only apply and use the bond funds and other trust funds and property belonging to the bondholders upon the payment thereof in the order of such presentation. Such application as between a bondholder having an unmatured bond and a bondholder having a matured bond would require payment in full of the matured bond, if presented, before any trust funds could be applied upon payment of the unmatured bond. This

seems to be the positive injunction of Chapter IX, and whether it destroys the plan of composition or not, must be observed.

This same principle applies to the next subject now discussed.

SIXTH PROPOSITION: THE DECREE UNLAWFULLY TAKES TRUST FUNDS AND VESTED RIGHTS BELONGING TO THE APPELLANTS.

Assignment of Error No. 22 reads:

> "The court erred in entering a decree herein taking vested rights of the appellants."

Assignment of Error No. 23 reads:

> "The court erred in taking jurisdiction of the public trust imposed upon the Merced Irrigation District under the California Irrigation District Act and in administering the same and in depriving the appellants of their rights as beneficiaries of such trusts."

The following trust funds and vested rights are subject to this rule:

(1) The right to a writ of mandate to compel payment of trust moneys to bondholders and to compel a levy of assessment is a vested right.

Except for the effect of the bankruptcy statute the appellants were at the time of the filing of the petition entitled to writs of mandate to compel the application of trust funds to the payment of appellants' matured claims and to compel levy of assessments. *Moody v. Provident Irrigation District,* 96 C. D. 512; *El Camino Irrigation District v. El Camino Land Corporation,* 96 C. D. 505; *Selby v. Oakdale Irrigation District,* 140 C. A. 141. In fact, the only remedy which a bondholder had was his right to a writ of mandate under these decisions.

Where the writ of mandate is thus given it is a writ of right. *Borough of Fort Lee v. U. S.,* 104 Fed. (2d) 275.

(2) The money belonging to the bond funds are trust funds in which the appellants had a vested right. *Selby v. Oakdale Irrigation District,* supra; *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 385.

(3) Other trust properties which are taken by the bankruptcy decree are the following:

(a) Trust funds which have been unlawfully diverted and which should be replenished from funds on hand (R. 412-414)	$717,932.50
(b) Tax deeded lands (R. 678)	672,885.14
(c) Rentals, including water tolls per year (R. 881)	60,000.00
(d) Tax Sale Certificates (R. 889)	206,096.93
(e) In addition, all assets not needed for the operation and maintenance of the district.	

In the case of *Clough v. Compton Delevan Irrigation District,* 96 C. D. 509, the Court referred to Section 29 of the California Irrigation District Act. Section 29 reads in part:

> "The legal title to all property acquired under the provisions of this Act shall immediately and by operation of law vest in such Irrigation District and shall be held by such District in trust for and is hereby dedicated to and set apart for the uses and purposes set forth in this Act."

In the last-mentioned case the Court construing Section 29 said:

> "The property is by this language impressed with public use, and the trust is for all the purposes of the Act. Payment of the bondholders is such a purpose. * * *".

In the case of *McKaig v. Moutrey,* 9 C. A. D. 335, 90 Pac. (2d) 108, the Court said:

> "The officers and directors became trustees for the district and its bondholders when the assessment to pay bond principal and interest was levied, and the assessment when so levied, became the property of the district and was held in trust for the bondholders under section 29 of the Irrigation District Act."

It is respectfully contended that this decree unlawfully takes trust properties belonging to the appellants.

SEVENTH PROPOSITION: BY THE TERMS OF THE STATUTE THE COURT WAS WITHOUT JURISDICTION.

Assignment of Error No. 7:

> "The Interlocutory Decree in this cause interferes with the political and governmental powers of the Merced Irrigation District and the property and revenues thereof necessarily essential for governmental purposes."

Assignment of Error No. 8:

> "By the provisions of Section 83 of the Bankruptcy Act the court is without power to apply its order to this irrigation district."

It is respectfully suggested that the Court was wholly lacking in jurisdiction. The petitioner being exclusively governmental in nature seems to be entirely excluded by the terms of the act under which these proceedings were prosecuted.

In Section 83 (c) of the Bankruptcy Act, which is Section 403, Title 11, U. S. C., after stating that the Court may enjoin proceedings and put the plan temporarily into effect, it is provided:

"* * * but shall not, by any order or decree, in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the petitioner; * * *".

To make doubly sure that the political or governmental affairs of the State were not to be interfered with, Congress inserted in the Act subdivision (i) of the same section (83) which reads as follows:

"(i) Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its political or governmental powers, including expenditures therefor."

Then further, to guard against the Act failing entirely because some petitioner might be a governmental agent Congress inserted:

"That if any provision of this chapter, or the application thereof to any such taxing agency or district or class thereof or to any circumstance, is held invalid, the remainder of the chapter, or the application of such provision to any other or different taxing agency or district or class thereof or to any other or different circumstances, shall not be affected by such holding."

Tit. 11, Sec. 401, U. S. C.

Subdivision (c) 11 of the old section 80 is as follows:

"But (11) shall not, by any order or decree, in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the taxing district."

The similarity between Subdivision (c) 11 of Section 80 and Subdivision (c) of Section 83 above quoted is at once striking. Indeed they are identical with one exception. The last two words of the old act are "taxing district"

and the last word of the new act is "petitioner". This difference may be more important than it at first appears. The Court held the old act unconstitutional in the *Ashton* case. (*Ashton v. Cameron County Water Improvement Dist. No. 1,* 298 U. S. 513.)

The basis of the decision in the *Ashton* case may be stated in two or three rather short quotations from that opinion where the Court said (531):

> "If obligations of States or their political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs; the will of Congress prevails over them; although inhibited, the right to tax might be less sinister. And really the sovereignty of the State, so often declared necessary to the federal system, does not exist."

And again:

> "The constitution was careful to provide that 'No state shall pass any law impairing the Obligation of Contracts'. This she may not do under the form of a bankruptcy act or otherwise." (Authority.) "Nor do we think she can accomplish the same end by granting any permission necessary to enable Congress so to do."
>
> "Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted." (Authority.) "The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation."

The new act, so far as the constitutional question is concerned, was approved in the *Bekins* case (*U. S. v. Bekins,* 304 U. S. 27). After quoting at some little length from the report of the Judiciary Committee of the House, which committee report we will presently refer to, Mr. Chief Justice Hughes stated (51):

> "We are of the opinion that the Committee's points are well taken and that Chapter X is a valid enactment. The Statute is carefully drawn so as not to impinge upon the sovereignty of the State."

It will be observed that the Court in the *Bekins* case does not assent to the proposition that the sovereignty of the State may be impinged upon.

The material differences between the two statutes, if any there be, are elusive in the extreme. The *Ashton* case held the act void. The *Bekins* case holds a very similar act valid. One of two things, therefore, seems certain. The Court in the *Bekins* case must have either found some material difference between the old and the new statutes, even though slight it may be, which clears away the difficulties found in the old statute, or the *Ashton* case is actually overruled. If the *Bekins* case overrules the *Ashton* case, then the plea in this case of *res judicata* would seem to be perfectly good, but that is another point which we are not here discussing, but will presently discuss.

The Court in the *Bekins* case (50) referring to the *Ashton* case and its holdings in that case, stated:

> "* * * that if obligations of States or their political subdivisions might be subjected to the interference contemplated by Chapter IX, they would no longer be 'free to manage their own affairs.'
>
> In enacting Chapter X the Congress was especially solicitous to afford no ground for this objection."

The Court does not give us the differences between the two acts or wherein the solicitation of Congress has removed the objection found in the *Ashton* case, but unless the Court actually overruled the *Ashton* case, it must have found some difference upon this particular point and that difference may be as between the words "petitioner" set

out above from Section 83 (c) and the words "taxing district", set out above from Section 80 (c) (11). And we can see some little difference between those terms.

In the old Act the term "taxing district" was defined as,

> "any municipality or other political subdivision of any state, including (but not hereby limiting the generality of the foregoing) any county * * *", etc.

including irrigation districts.

Now, the Court in the *Ashton* case held the old act void. The respondent in that case was a water improvement district exactly similar to an irrigation district. The Court said:

> "If Federal Bankruptcy laws can be extended to respondent, why not to the State?"

It will be remembered that in the old Act the respondent was defined as a political subdivision. Again in the same decision the Court said (527):

> "It is plain enough that respondent is a political subdivision of the State, created for the local exercise of her sovereign powers, and that the right to borrow money is essential to its operations. * * * Its fiscal affairs are those of the State, not subject to control or interference by the national government, unless the right so to do is definitely accorded by the Federal Constitution."

Now we turn to the new act, the one construed in the *Bekins* case, and we find the term "petitioner" defined in Section 82 as "any taxing agency or instrumentality referred to in Section 81 of this Chapter."

When we look at Section 81 we find that irrigation districts and numerous other agencies are named by name but they are not defined as political subdivisions, and at the end of Section 81 we find this very significant language, already quoted above:

> "Provided, however, that if any provision of this chapter, or the application thereof to any such taxing agency or district or class thereof or to any circumstance, is held invalid, the remainder of the chapter, or the application of such provision to any other or different taxing agency or district or class thereof or to any other or different circumstances, shall not be affected by such holding."

The *Ashton* case had held old Chapter IX to be void because it permitted interference with the governmental sovereignty of the State. The *Bekins* case seems to hold that the governmental intereference has been avoided in the new statute, at least so far as its general constitutionality is concerned.

When we turn to the new statute we find that Congress has named a great number of agencies, and, not being sure but that some of these agencies may be strictly governmental and thus fall into the category condemned in the *Ashton* case, it provides at the end of Section 81 as above quoted and proceeds to at least attempt to save the act as to those which do not fall within the class which Congress has no power to interfere with.

Since all of the agencies in the old act, by definition of Congress, fell within the sovereign governmental class the old act was condemned in its entirety. Now, since it is possible that some or perhaps a large number of the agencies named in the new act would not come within that class, the act as a whole is not condemned, and it is not condemned as to the particular agency before the Court, because the Courts of California had not held such agencies to be strictly governmental. This seems to be a reasonable construction to place upon the *Bekins* decision, and indeed seems to be about the only way that it can be explained without reaching the conclusion that the *Ashton* case is actually overruled.

This construction seems to be borne out further by the decision in the *Bekins* case where the Court quotes with approval from the report of the Judiciary Committee of the House and States (51):

> "The bill here recommended for passage expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. *No interference with the fiscal or governmental affairs of a political subdivision is permitted.* * * * No involuntary proceedings are allowable, and no control or jurisdiction over that property and those revenues of the petitioning agency *necessary for essential governmental purposes is conferred by the bill.*" (Italics supplied.)

Now, the committee of Congress apparently had this very point in mind, namely, that it could not pass an act that would apply to a state or to any strictly governmental agent or the state but only to those agencies that exercised private or proprietary functions. Congress seemed to recognize that the first act had failed largely because, if not entirely because, it applied entirely, by definition, to municipalities and political subdivisions which exercise governmental or sovereign powers. In the new act it tried to avoid that difficulty by withholding jurisdiction from the Court to deal with those agencies which are strictly governmental and the governmental functions of the agencies which may be partly governmental and partly proprietary.

We now come to a consideration of the nature of an irrigation district in California.

It is not important on this particular point whether the *Ashton* case was actually overruled or not. Congress in the very act under which such jurisdiction as the Court could exercise was conferred, expressly provided that no order could be made that would interfere with any of the political or governmental powers of the petitioner. It be-

comes important therefore to ascertain whether or not the petitioner has any powers which the Court had the right, by its order, to interfere with.

For many years the exact nature of an irrigation district has been a subject of judicial concern. That question has been definitely crystalized in California, so far as California irrigation districts are concerned, *since the decision in the Bekins case.*

In the case of *El Camino Irrigation District v. El Camino Land Company,* 12 Cal. (2d) 378, 383, the Court states:

> "But the cases make a sharp distinction between municipal corporations, such as the cities in the Kuback Co. and Marin Water and Power Co. cases, and state agencies such as irrigation or reclamation districts. These latter are agencies of the state whose functions are considered exclusively governmental; their property is state owned, held only for governmental purposes; they own no land in the proprietary sense, within the rule of defendant's cases. (See Whiteman v. Anderson-Cottonwood Irrigation District, 60 Cal. App. 234; Turlock Irrigation District v. White, 186 Cal. 183, 187; Wood v. Imperial Irrigation District, 216 Cal. 748, 752.)"

The still more recent case decided by the Supreme Court of California is that of *Anderson-Cottonwood Irrigation District v. Klukkert, as Assessor,* 97 C. D. 348, 352. In the *Anderson-Cottonwood* case the District had taken over a good deal of land through its assessment proceedings and the County Assessor was threatening to assess these lands for county tax purposes and the proceeding was one to prohibit such an assessment. The Court reviewed the authorities at some length and said:

> "Irrespective of that which hereinbefore has been stated with respect to the rule that under a constitutional provision exempting state-owned property from taxation it is immaterial whether the property is held

in a proprietary or a governmental capacity, it does not appear that the lands here involved are non-operative, within the meaning contended for by respondents. In the recent case entitled El Camino Irrigation District v. El Camino Land Corporation et al., 96 Cal. Dec. 505, at pages 508, 509, this court held that an irrigation district was an agency of the state, whose functions were considered exclusively governmental; that it owns no lands in a proprietary sense, *its property being owned by the state and held only for governmental purposes.* The court pointed out that under section 29 of the Irrigation District Act (Deering's Gen. Laws (1931), Act 3854, p. 1948) it was provided that property acquired by the district should be held 'in trust', and was 'dedicated and set apart to the uses and purposes' set forth in the act. (See, also, Clough v. Compton-Delevan Irrigation District et al., 96 Cal. Dec. 509, 511; Moody v. Provident Irrigation District, 96 Cal. Dec. 512, 515.) Also, in the recent case entitled Provident Land Corporation v. Zumwalt et al., 96 Cal. Dec. 497, where the economic history of irrigation districts in this state was reviewed at some length, it was held that lands acquired by the district under the provisions of the Irrigation District Act remain in trust, and that their proceeds, whether by sale or lease, were likewise subject to the trust."

A still more recent case is that of *Glenn-Colusa Irrigation District v. The Board of Supervisors of Colusa County,* 96 C. A. D. 882. In that case the irrigation district had in a warehouse, a certain amount of grain that had been taken as rental for tax deeded lands held by the District. The County assessed the grain, the District applied to the Board of Supervisors to cancel the assessment, which was refused, and an application was made to the Court for an order compelling the cancellation of the assessment. The assessment was cancelled on the ground that the District owned no property in any proprietary

sense but wholly in a governmental sense and was not subject to taxation.

Now the law in California is no different today than it has always been. Our Courts have simply told us what the law is, in relation to the nature of an irrigation district and that is, that it being purely a creature of the state for state purposes, all the functions of such a district are governmental.

Congress has stated that the Court shall not by any order or decree in the proceeding or otherwise interfere with any of the political or governmental powers of petitioner. If all of the powers and functions of the petitioner are governmental, then it would seem too clear for argument that the Court could make no valid order or decree in these proceedings.

It may be argued that no order or decree contemplated in these proceedings would *interfere* with any of the functions of the district. The slightest reflection demonstrates that such is not the case. One of the functions of the district is to borrow money and issue bonds. Another function enjoined by law and for the enforcement of which mandamus will lie is the levying of assessments to pay the bonds in full according to their terms. Whereas, now mandamus will lie to require the levying of such an assessment, after the order in this proceeding is final, an injunction will lie to prohibit such an assessment. The whole purpose of the proceeding is to change the fiscal affairs of the district. After that change has been made the district will have no power to proceed on the old basis established by State law but will be required to proceed upon the new basis established by the Federal Bankruptcy Court.

In the *Bekins* case Mr. Chief Justice Hughes in referring to the *Ashton* case said:

> "* * * the court considered that the provisions of Chapter IX authorizing the bankruptcy court to entertain proceedings for the 'readjustment of the debts' of 'political subdivisions' of a State 'might materially restrict its control over its fiscal affairs', and was therefore invalid; that if obligations of States or their political subdivisions might be subjected to the *interference* contemplated by Chapter IX they would no longer be 'free to manage their own affairs'." (Italics supplied.)

Now, we have the *Bekins* case either overruling the *Ashton* case (supra) or finding something in the new act that saves the governmental or sovereign functions of the petitioner from the effects of the new act. We have our own State Court holding flatly and unequivocably that every function of the irrigation district is a governmental function and that it owns no property of its own but the property which stands in its name is the property of the State and is used for governmental purposes and impressed with a trust for that purpose, and that it is neither subject to execution nor taxation. We find the act under which these proceedings are pending expressly prohibiting the Court from making any order or decree that will interfere with the political or governmental functions of petitioner, and we find that no order or decree could be made that would not interfere with one or more of these governmental functions.

So it would appear that there is only one possible basis left upon which the Court could exercise any jurisdiction in these proceedings and that is for the Court to take the position that the Federal Court is not bound by the State Court decisions and that actually these great sovereign functions of taxation which are exercised by the petitioner and which will be directly affected by the decree in this proceeding and will have to be exercised in the future in

accordance with such decree are, after all, not governmental at all but are in the nature of private functions.

The Supreme Court in the *Tompkins* case held that on questions of State law United States Courts are bound by the decisions of the State. (*Tompkins v. Erie Railroad Company,* 304 U. S. 64.)

Section 34 of the Judicial Code, Title 28, Section 725 U. S. C. A. provides:

> "The laws of the several States, except where the Constitution, Treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply."

The irrigation district is a creature of statute and the highest court of the state that brought the district into existence, has interpreted its charter. That interpretation is laid beside the act of Congress and by that act the district is apparently excluded from its operation.

It has been a general rule of construction since the earliest time that the United States Courts will follow the State Court in a construction of a State statute or a State constitutional provision.

Town of South Ottawa v. Perkins, 94 U. S. 260, 267.

The recent California Supreme Court decisions above cited, are but crystallizations, as it were, of the older cases on the same points. Those cases are reviewed to some extent in the *Anderson-Cottonwood* case and it would seem that even in the absence of the *Tompkins* case the United States Courts would be bound by the State decisions as to the nature of an irrigation district.

The position taken is greatly strengthened by subdivision (i) of Section 83 where it is stated:

> "Nothing contained in this chapter shall be construed to limit or impair the power of any state to control,

> by legislation or otherwise, any municipality or any political subdivision of or in said state in the exercise of its political or governmental powers, including expenditures therefor."

Now, there are just two ways, with which we are familiar, by which the State may control anything. First, is by legislation and second is by judicial construction. In these proceedings we have pleaded another action pending under a state law. The legislature of the State passed what is referred to as the Irrigation District Refinancing Act. (1937 Stats. p. 92.) That act sets up machinery for accomplishing substantially the same thing that the bankruptcy statute purports to authorize. This district proceeded under that statute and the action is still pending. That statute has not been repealed. So the legislature has itself stepped in and set up procedure for accomplishing a similar purpose and to that extent has undertaken the control of these agencies. That subject, however, we will discuss under another heading.

Since Congress itself has expressly provided that the Court is without power to make any order or decree interfering with the political or governmental powers of the petitioner it would seem that the Court is entirely without jurisdiction to make any order or decree in these proceedings.

Apparently this same point was raised in the case of *George E. W. Luehrmann, et al. v. Drainage District No. 7 of Poinsett County, Arkansas,* decided June 13, 1939, by the Circuit Court of Appeals for the Eighth Circuit. (104 Fed. (2d) 697.) In that case the Court said:

> "A former Act (May 24, 1934) permitting municipal corporations and other political subdivisions of states, unable to pay their debts as they mature, to resort to the federal courts of bankruptcy to effect readjustment of obligations, was before the Supreme Court in Ashton v. Cameron County Water Improvement District No. 1, 298 U. S. 573. It was there held that

the power claimed in support of the Act, as applied to the district organized to permit water for irrigation and domestic purposes, having power to sue and be sued, issue bonds, and levy and collect taxes, was unconstitutional, as restricting the states in the control of their fiscal affairs. The appellant district there was held to be a political subdivision of the state.

The Act of August 16, 1937, under which this proceeding was brought, undertakes to meet the constitutional weakness of the former Act by the following provisions:

> 'That if any provision of this chapter, or the application thereof to any such taxing agency or district or class thereof or to any circumstance, is held invalid, the remainder of the chapter, or the application of such provision to any other or different taxing agency or district or class thereof or to any other or different circumstances, shall not be affected by such holding.'
>
> (11 U. S. C. A. 1222, Sec. 401.)

In Drainage District No. 2 of Crittenden County, Arkansas v. Mercantile Commerce Bank & Trust Company, 69 F. (2) 138, this court held that an Arkansas Drainage District is *not a governmental agency* as respects the question of whether the district is subject to equity jurisdiction. This ruling is based upon the decisions of the Supreme Court of Arkansas holding that drainage districts are quasi-public corporations which are not political or civil divisions of the state like counties and municipal corporations created to aid in the general administration of the government. They are not created for political purposes, nor for the administration of the government. *Appellants do not contend* that the petitioner falls within the limitation upon the power springing from this amendment to the Bankruptcy Act, which limitation was declared in the Ashton case. * * * It appears further that unless and until that composition is effected, the district is hopelessly insolvent, and that the Act of August 16, 1937 is valid as applied to this drainage district, which is not a *governmental agency.*'' (Italics supplied.)

EIGHTH PROPOSITION: THERE IS ANOTHER ACTION PENDING IN THE STATE COURTS OF CALIFORNIA UPON THE IDENTICAL CAUSE OF ACTION AND DEMANDING THE SAME RELIEF, AND THAT THAT ACTION WAS COMMENCED AND PENDING UNDER STATE LAW PRIOR TO THE PASSING OF CHAPTER X OF THE BANKRUPTCY ACT UPON WHICH THIS PROCEEDING WAS PROSECUTED.

Assignment of Error No. 5: "The proceedings herein were and are barred by proceedings pending in the Superior Court of the State of California under the provisions of Statutes of California 1937, Chapter 24". (R. 283.)

In March 1937, there was passed by the California Legislature as an urgency measure, which took effect upon its approval, an act designated "Irrigation District Refinancing Act". (1937 Stat. p. 92.)

Briefly that act provides that any irrigation district being unable to pay its debts as they mature, such debts may be liquidated, refinanced, or readjusted as therein provided. Such a proceeding is initiated by the Board of Directors of the district who shall adopt a plan. The plan must be concurred in by two-thirds in principal amount of the holders of each class of security affected thereby. The plan shall be presented to the California Districts Securities Commission and if found to be fair and equitable to the creditors the Commission shall approve the same and the board of directors is then authorized to file in the Superior Court in the county in which the district or the major part thereof is located, a verified petition stating that the district is unable to meet such obligations as they mature; that it desires to effect the plan adopted and that it has been accepted by a sufficient number of creditors, and the district desires to avail itself of the act. The Act provides that after the petition is filed the plan shall temporarily be in effect and that the filing of the petition shall automatically enjoin and stay, pending final determination of the proceedings as therein set forth, the commencement or continuance of

proceedings or suits against the district or any officer thereof and shall enjoin and stay the enforcement of any lien or the levy of assessments except as is consistent with and in furtherance of the plan and that the Court in which the petition is filed shall have *exclusive jurisdiction* (Sec. 5 of the Act) with respect to all suits, actions and proceedings against the district on account of the indebtedness affected.

It is then provided in the act that 90 days' notice of hearing be given and that thirty days' notice be personally served upon all known holders of bonds and warrants affected by the plan and at any time prior to the hearing any creditor affected by the plan may file an answer; that changes or modifications may be made, and the Court if it finds the plan to be fair and equitable and that it complies with the provisions of the act and has been accepted in writing by the required number of creditors and the offer and acceptance are in good faith and that the district is authorized to take the necessary action to carry out the plan, shall make an interlocutory judgment approving the plan. This decree does not enforce the plan as against non-consenting creditors.

A separate hearing follows in which the rights of non-consenting creditors is determined. This latter hearing is in the nature of a condemnation proceeding.

There are two other provisions of the act to which we wish particularly to direct the Court's attention. They are Sec. 19 and Sec. 5.

Sec. 5 which is entitled "Automatic Stay" provides:

> "* * * The Court in which said petition is filed shall have exclusive jurisdiction with respect to all suits, actions and proceedings against the district—and all matters incidental and collateral thereto * * *"

and the section operates to stay all such suits and proceedings.

The Supreme Court of California in the case of *Morris v. South San Joaquin Irr. Dist.*, 9 Cal. (2d) 781, held that *it,* the Supreme Court, could not properly proceed with the conduct of a writ of mandate matter to compel payment of bonds and coupons while a proceeding under this state act was pending.

Section 19 of the act has a rather startling legislative declaration which shows how completely the state Court has and maintains jurisdiction. We quote the following excerpt:

> "In the event that said petition for liquidation, refinancing or readjustment is dismissed, or that any of the provisions hereof for confirmation of the plan or acquisition of the bonds or warrants of the non-accepting holders shall be declared invalid, such dismissal or declaration shall not affect the effectiveness of the plan with respect to the district or holders of bonds or warrants accepting the same."

In other words, by this section it appears that the legislature intended that when a plan has been adopted and has been accepted by the requisite number of creditors and a proceeding started that no matter what may happen thereafter in that proceeding the plan is in effect and both the district and the accepting creditors are bound by it.

It will be recalled that the petition of the district under the state act was filed in the state Court at Merced in July, 1937, and the bankruptcy act under which the district is now attempting to proceed in this Court was not passed by the Congress until August of the same year. These dates are all important.

These appellants took the position at the time the action was filed in the state Court and have continued to hold that position that the state act is unconstitutional, but neither the petitioner nor the Court in which the action was pending has agreed wih appellants in that respect, and the petitioner and the Court, over the protest of the

appellants, continued to the point where judgment was ordered in favor of the petitioner. (R. 381-383.) Of course the very strong presumption is that the act is constitutional, and the constitutional question cannot be here discussed as it is entirely collateral to this proceeding.

It is extremely interesting to note that neither the petitioner nor the state Court seemed to regard the Federal Act as in any manner affecting the right or jurisdiction of the state Court to proceed. The Federal Act was passed in August, 1937. Notwithstanding that Act, the petitioner brought its state action under the state act to trial and it was as late as March 10, 1938, that the state Court ordered judgment entered in the state action under the state act as prayed for by the petitioner. (R. 381-383.) It was not until long after the Supreme Court of the United States had passed upon the new bankruptcy act that petitioner decided to suspend prosecution of the state proceeding and go to the bankruptcy Court. That cannot be done. The petitioner elected to proceed under the state act in the state Court and it must stay with that proceeding at least until there is a finality to that proceeding. That point has not yet been reached. We have seen by the terms of Section 19 of the Act how complete that election is. It apparently cannot be abandoned.

It will be recalled that these respondents were brought into the bankruptcy Court under Chapter IX of the Bankruptcy Act back in 1935. (Exs. "P", "Q", "R", R. 797, 798.) After Chapter IX was held unconstitutional by the Supreme Court the District Court dismissed that proceeding. (R. 798.) Then the petitioner went into the state Court and these respondents were again forced to defend themselves in a long tedious proceeding. Now they are asked to temporarily ignore that proceeding and go back to the bankruptcy Court to do it all over again. If

the petitioner fails here then presumably the state action will be again picked up.

If the state Court had jurisdiction in July, 1937, or March, 1938, it still has jurisdiction. Nothing has happened in the meantime to change that situation. For several months prior to the trial of the state action Chapter X of the Bankruptcy Act was on the books. If the passage of the Bankruptcy Statute superseded the state act concerning an action that was then pending it would have been a conclusive defense in the state Court, but that is not the case. The law seems to be well settled that where the proceeding is pending under a state act at or prior to the time of the passage of the Bankruptcy Statute, the state Court continues to have jurisdiction under a valid state act until that proceeding is finally determined. If that is the law, and it seems to be, then for the Bankruptcy Court to proceed in this proceeding means that two Courts in two separate jurisdictions are proceeding at the same time to occupy the same field in administering the same estate.

If it should be considered that both the District Court and the state Court had concurrent jurisdiction then the law is perfectly well settled that the moving party is put to his election as to which Court's jurisdiction he will invoke and the one first invoked has exclusive jurisdiction from then on. (15 C. J. 1131.) The situation that exists here, however, is not one of concurrent jurisdiction but one in which the federal Court had no jurisdiction over those matters that were pending in the state Court for a similar purpose at the time the Bankruptcy Act was passed. If the act under which the state Court is acting is constitutional, then clearly the state Court at Merced had and still has exclusive jurisdiction over the subject matter of this controversy. (R. 381.) This we now show.

A STATE PROCEEDING PENDING UNDER AN INSOLVENCY LAW OF THE STATE AT THE TIME OF THE PASSAGE OF A BANKRUPTCY ACT IS UNAFFECTED BY THE PASSAGE OF SUCH ACT.

The foregoing proposition seems to have been uniformly held to be the law. While there are not a great number of authorities on the point, one way or the other, after a considerable search we have found none denying the above proposition, but we find a number of authorities supporting it.

Several authorities are collected in a note in 45 L. R. A., at page 187, supporting the following statements of the author of that note, where he says:

> "Proceedings under State insolvency laws pending at the time of the passage of a bankrupt act are not affected by the latter act."

Mr. Justice Story is quoted from in the case of *Larrabee v. Talbott,* 5 Gill (Maryland) 426, 46 Amer. Dec. 637, as follows:

> "That as soon as the bankrupt act went into operation, in February, 1842, it ipso facto suspended all action on future cases, arising under the state insolvent law, where the insolvent persons were within the purview of the bankrupt act. I say future cases, because very different consideration would or might apply, where proceedings under any state insolvent laws were commenced, and were in progress before the bankrupt act went into operation * * *"

In *Martin v. Berry,* 37 Cal. 208, 211, the Court said:

> "If a State Court has acquired jurisdiction under a state law of a case in insolvency, and is engaged in settling the debts and distributing the assets of the insolvent before or at the date at which the Act of Congress upon the same subject takes effect, the State Court may, nevertheless, proceed with the case to its final conclusion, and its action in the matter will be as valid as if no law upon the subject had been

passed by Congress. This question arose in the case of Judd v. Ives, 4 Metcalf, 401, and was determined as just stated."

In *Minot v. Thacher,* 7 Metcalf (Mass.), 348, 41 Amer. Dec. 444, the Court said:

"The proceedings under the insolvent law having been instituted before the bankrupt act was enacted, they could not be superseded by the application, under the bankrupt law * * *"

In *Greenfield Bros. v. Brownell* (N. M. 1904), 76 Pac. 31, referring to Bankruptcy Act of 1898:

"* * * It was only intended to act in the future, and to take cognizance of such acts of bankruptcy as were committed after its passage. As to acts committed under its passage, there could be no collision between the bankrupt laws and the laws of this territory which we are now considering, because the bankrupt law was not, and could not under its express terms be operative as to acts committed before its passage. We can see no reason for not permitting an action brought under the territorial statutes to proceed, * * * Unless this construction is held, it is obvious that the bankruptcy law might act as a shield * * *" etc.

See also *Day v. Bardwell,* 97 Mass. 246, 255.

In re Bruss-Ritter Co., 90 Fed. 651, the Court had before it an involuntary bankruptcy proceeding under the act of 1898. That act provided for a certain day on which it would take effect, and also provided that involuntary proceedings could not be commenced within four months after that date. During that four months period an insolvency proceeding was commenced in the state Court. A motion was made to dismiss the bankruptcy proceeding on the ground that an action was pending in the state Court when the bankruptcy act took effect. The Court seems clearly to recognize the rule, but held that while

an involuntary proceeding could not be filed within that four months' period, still the act actually took effect at the earlier date and prior to the commencement of the action in the state Court. The Court necessarily denied the motion, but it was clearly indicated that had the state proceeding been pending prior to the effective date of the Bankruptcy Act or prior to its passage, then the motion would have been good.

In the nature of things this question would not often arise, but as above indicated, so far as we have been able to find, every time the question has arisen it has been decided as above indicated, namely, that when the proceeding under an insolvency act of the state is pending at the time of the passage of the Bankruptcy Act that proceeding is unaffected and the Court in which it is pending has jurisdiction to carry that proceeding on to conclusion. If that be the case then the federal Court does not have jurisdiction of the same matter at the same time. Since the United States Court does not seem to have jurisdiction while that jurisdiction is in the state Court, we suggest that this proceeding ought to be now ordered dismissed.

Quite apart from the foregoing, two further considerations must be kept in mind. The first is that the existence and effect of such a state law is anticipated and allowed for by the terms of Chap. IX providing that no decree of the Court shall interfere with the state's control of the political and governmental operation of its agencies; and second, the California Legislature in the enactment of Sec. 19 of the act seems to have undertaken to provide that in event of failure of any portion of the act or dismissal there should be in any case a validating and confirming of the contract of novation as between the district and accepting creditors.

NINTH PROPOSITION: IT IS RES JUDICATA BETWEEN THE PARTIES THAT THE CONSTITUTION FORBIDS THE GRANTING OF THE RELIEF SOUGHT.

Assignment of Error No. 4 reads:

"The cause is *res judicata.*"

For discussions of the proposition stated in the heading, we refer to the two separate briefs filed respectively by Mr. George Clark, and by Brobeck, Phleger & Harrison.

It is, we submit, there shown:

(a) That the rule of *res judicata* applies to issues of law as well as to issues of fact;

(b) That questions of constitutional law and questions of jurisdiction become *res judicata* between the parties just as other issues do;

(c) That the final determination of such questions is concluded once and for all between the parties, even though that determination is later departed from;

(d) That here, therefore, the determination, in the earlier case between the parties, that the Constitution forbids the granting of the relief here sought, is *res judicata* between the parties, and so determinative of this case.

TENTH PROPOSITION: CHAPTER IX OF THE BANKRUPTCY ACT IS VOID AS APPLIED TO APPELLANTS.

Assignment of Error No. 1 reads:

"Chapter IX of the Bankruptcy Act of the United States is unconstitutional and void and affects the property interests of the appellants in that it violates Article I, Section 10, Clause 1, of the Constitution of the United States and the Fifth, Tenth and Fourteenth amendments to the Constitution of the United States."

Assignment of Error No. 2 reads:

> "The State of California has not consented and cannot consent to these proceedings." (R. 283.)

The decision of the Supreme Court of the United States in *United States v. Bekins,* 304 U. S. 27, 58 S. Ct. Rep. 811, is not conclusion of the validity of Chapter IX of the Bankruptcy Act as applied in this case, for the reason that the *Bekins* case does not deal at all with several factors present in this case, which, we submit, render application of the statute to appellants herein unconstitutional.

(a) As here applied, the Bankruptcy Act prefers junior liens to senior liens, and discriminates among liens of equal rank.

The case of *Northern Pacific Ry. Co. v. Boyd,* 222 U. S. 482 (as elaborated in later decisions), establishes the following fundamental qualities that a plan of corporate organization must have to be binding on non-consenting creditors:

> (1) It must give precedence to the entire claims of creditors, including unsecured creditors, over any participation or interest of stockholders in the old company.
>
> (2) The entire amount of claims of a preferred class must have precedence over claims of subordinate classes.
>
> (3) The plan must not discriminate among the members of any one class of creditors.

The fourth syllabus in *Kansas City Terminal Ry. Co. v. Central Union Trust Co.,* 271 U. S. 445, reads in part as follows:

> "* * * a plan of reorganization of railroad company which does not give precedence to entire claim of unsecured creditors over any part or interest of stockholders in old company, is insufficient as to unsecured creditors, and not binding on them."

It is well settled that for a plan to be fair as between classes of creditors, it must satisfy their claims in the order of priority.

Louisville Trust Co. v. Louisville Ry. Co., 174 U. S. 674;

St. Louis-S. F. Ry. Co. v. McElvain, 253 F. 123;

Mountain States Power Co. v. Jordan Lumber Co., 293 F. 502.

In *Eagelson v. Pacific Timber Co.,* 270 Fed. 1008, the plan gave persons holding common stock share for share in the new company, but holders of common who also held preferred stock were not permitted to trade in their common until they had paid $10 in cash for each share of preferred, for which they received a new preferred share of $10 par value. The majority of common stockholders held common only. The dissenting minority held common and preferred in about equal amounts. The Court said at page 1110:

> "* * * The several holders of the common stock were, among themselves, denied equal rights of participation in the new company * * * as the holders of more than half of the common stock * * * had none, or practically no preferred stock, while many persons, including the plaintiff and the intervenors, held substantially equal amounts of preferred and common stock, it is manifest that the plan of reorganization was for the benefit of the majority to the detriment of the minority, and consequently unfair and fraudulent."

We respectfully submit that the principles referred to above are fundamental, and inherent in the idea of bankruptcy.

As applied to debts of governmental agencies, Section 80 inevitably violates each of them, as we now propose to show.

Much of the land within the Merced Irrigation District is subject to mortgages securing debts owing to banks and individuals. (R. 416, 420.)

In addition to being encumbered by the bonds of Merced Irrigation District, most of the lands in the district are burdened with bonds of one or more other public agencies. Wholly or partly within Merced Irrigation District are to be found five road districts, three high school districts, thirty-five grammar school districts, one mosquito district, three drainage districts, and three cities, all of which have outstanding bonds collectible by assessment upon lands in the respective districts mentioned. In addition, the county itself has outstanding a large amount of bonds. (R. 957-958.) Under the law of California the bonds of most of the foregoing public agencies are of equal rank.

LaMesa Irr. Dist. v. Hornbeck, 216 Cal. 730;
San Joaquin Irr. Dist. v. Neumiller, 2 Cal. (2d) 485.

The result therefore of the application of Chapter IX of the Bankruptcy Act to the petitioner is to prefer junior claims to senior claims, and to discriminate among claims of equal rank.

We submit that this result of the application of the Bankruptcy Act to the present case violates the due process and equal protection laws of the United States Constitution. We submit further that under the *Boyd* case and the other authorities cited above, Chapter IX thus applied is not a law "on the subject of bankruptcies" within the meaning of that provision in the United States Constitution, and is therefore not a statute authorized to be enacted by that instrument.

(b) The California statute purporting to consent to this proceeding is void under the Constitution of California.

As declared by the United States Supreme Court in the *Bekins* case, 304 U. S. 27, 58 S. Ct. Rep. 811, Chapter IX of the Bankruptcy Act cannot be applied to any public agency of a state unless the state in question has consented.

A statute purporting to consent has been passed by the legislature of the state. (*California Statutes,* 1939, Chapter 72.) We submit that the statute is void under the Constitution of California and the decisions of the Supreme Court of California.

Section 16 of Article I of the Constitution of California provides that "no * * * law impairing the obligation of contracts shall be passed".

This prohibition applies to contracts of the State or its subdivisions as well as private contracts.

Floyd v. Blanding, 54 Cal. 41;

Meyerfeld, Jr. v. So. San Joaquin Irr. Dist., 3 Cal. (2d) 409.

It is of course settled that a statute materially impairing the remedies for enforcement of a contract impairs its obligation within the meaning of the constitutional prohibition.

Welsh v. Cross, 146 Cal. 621;

Jeffreys v. Point Richmond Canal Co., 202 Cal. 290.

If the federal bankruptcy Court has jurisdiction to enforce the scaling down of debts here sought to be accomplished its final decree, of course, puts an end to the power of the state Courts (or indeed any Court) to enforce the remedies given by law to bondholders for the protection of their rights.

It follows that the operation of the California statute purporting to consent to proceedings under Chapter IX of the Bankruptcy Act not only impairs, but wholly destroys, the remedies given by the California laws for the enforcement of the bonds of appellants.

We know of no reason to suppose that the Supreme Court of California would depart from the decisions above cited concerning the scope and effect of the provisions of the California Constitution forbidding the impairment of the obligation of contracts. This Court, we therefore submit, should assume, until it has otherwise been held by the state Courts, that the purported consent statute passed by the Legislature of California is void under the Constitution of the state. This being true, Chapter IX cannot validly be applied against appellants in this proceeding.

(c) The State cannot surrender its sovereign powers.

Since the decision of the *Bekins* case by the Supreme Court of the United States, it has been definitely settled that California irrigation districts are agencies of the state, exercising purely governmental functions.

Anderson-Cottonwood Irr. Dist. v. Klukkert, 97 Cal. Dec. 348, 88 Pac. (2d) 685.

For the state to attempt to surrender control over the powers and activities of such an agency is to attempt to surrender its sovereignty, *pro tanto.* This cannot be done.

Pollard v. Hagan, 3 How. 212;

U. S. v. Constantine, 296 U. S. 287.

CONCLUSION.

We respectfully submit, for the reasons stated above and in the separate briefs filed on behalf of individual ap-

pellants, that the judgment of the Court below should be reversed with directions to dismiss the proceeding.

Notwithstanding the great difficulties necessarily confronting appellants in attempting to rebut the evidence adduced by petitioner on the merits, it clearly appears, we submit, that unless the petition herein is to be taken as proving itself, it is clear on several independent grounds that petitioner is not in need of the relief sought in the plan of which it seeks approval.

Dated, October 16, 1939.

Respectfully submitted,

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Attorneys for Appellants,

Florence Moore; American Trust Company as trustee under a certain agreement between R. S. Moore and American Trust Company dated December 15, 1927; Crocker First National Bank, as trustee under a certain agreement between Florence Moore and Crocker First Federal Trust Company, dated December 15, 1937.

W. COBURN COOK,
Attorney for Appellants,

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Shanahan; Stephen H. Chapman; Edith O. Evans; J. Ofelth; Dante Muscio; I. M. Green; E. J. Greenhood; Julia Sunderland; Lily Sunderland; Florence S. Ray; Joseph S. Ray; Amelia Kingsbaker; S. Lachman Company, a corporation; Sue Lachman; Sophia Mackenzie; Nettie Mackenzie; R. J. McMullen; J. R. Mason; Gilbert Moody; William Payne; C. H. Pearsall; Alice B. Stein; Sherman Stevens; E. G. Soule; Margaret B. Thomas; Isabella Gillett and Effie Gillett Newton as executrices of the Estate of J. N. Gillett, deceased; Theo. F. Theime; Fletcher G. Flaherty; Frances V. Wheeler; Miriam H. Parker; Apphia Vance Morgan; First National Bank of Pomona; George F. Covell; Alma H. Woore; George Habenicht; Seth R. Talcott; Adolph Aspegren; J. H. Fine; Mrs. J. H. Fine; F. G. G. Harper; and W. S. Jewell.

(Appendix Follows.)

Appendix.

Appendix

SECTION 11 OF THE DISTRICTS SECURITIES COMMISSION ACT.

Sec. 11. Whenever any district has levied the annual assessment required by the laws of this State and when the money derived from said assessment, together with any other revenue allocated to payment of bond interest and principal, is insufficient to meet the bond interest or principal when due and said district defaults on its bond principal or interest, or both, to the extent of not less than twenty per cent (20%) of the amount due, said defaulting district may become subject to the section and to the control and direction of the commission as herein provided upon the application of such district and the approval thereof by the commission. Thereafter it shall continue subject to this section and to such control and direction during the effective period of this section unless and until the amount raised by its annual assessment as hereinafter provided, together with other revenue derived from any source and allocated to bond service or other outstanding obligations, shall be sufficient to meet and pay off all matured and uncanceled or unrefunded obligations of such district, bonded or otherwise, in which event it shall cease to be subject to this section and such control and direction shall terminate so long as said district does not again default as aforesaid. Upon receipt of written notice from any such district, the California Districts Securities Commission shall make such an investigation of the affairs of the district at the expense of the district as it may deem proper and for which funds are available in order to inform itself as to the financial affairs of the

district and its lands, and to enable it to carry out the provisions of this section intelligently.

The board of directors of any such defaulting district, in levying the annual assessment of the district, may, notwithstanding section 39 of the California Irrigation District Act or any other provision of law governing such district, levy only for such total amount as in their judgment by a finding of fact, approved by the commission it will be reasonably possible for the lands in said district, taken as a whole, to pay without exceeding a delinquency of fifteen per cent. In determining the amount it is possible for the lands to pay, at the time of each annual assessment, the board of directors shall consider the productivity of lands in the district, crops growing and to be grown during the year, market conditions as well as they can be forecast, the cost of producing and marketing crops, and obligations of the land respecting taxes and public liens. Out of the money derived from such annual assessment the board of directors of the district may set aside such sum as, in the judgment of said board, and approved by the commission, may be necessary, in addition to other revenue allocable to that purpose, for the operation and maintenance of said district and its works for the ensuing year. The balance of said money derived from such annual assessment shall be prorated to bond interest, bond principal and to other outstanding obligations of the district in the proportion that the total amount due on each of said items shall bear to the said balance.

Notwithstanding anything in this section contained, in any case in which an irrigation district has heretofore

defaulted or shall hereafter default in the payment of its indebtedness as in this act provided, no district shall be deemed to be or have been under the control or direction of the commission as in this section defined or under the supervision or control of the commission as to the fiscal affairs of such district until and unless the commission has or shall have made its order approving a reduced assessment.

This section shall remain in effect only until the first day of November, 1939, unless sooner repealed. The Legislature expressly declares that this section is intended to be applicable to all bonds, obligations and assessments of districts which have defaulted to the extent hereinbefore set forth, and the Legislature expressly declares that, except as otherwise expressly provided by law, it applies, and shall be considered to apply, to all bonds now or hereafter issued and outstanding. Nothing in this section contained, however, shall be deemed to extinguish or cancel any obligation due from any district, and whenever the annual assessment, levied as hereinbefore provided, leaves matured bond principal or interest or other matured obligations unpaid, said unpaid balance shall continue as a district obligation until paid or refunded in accordance with law.

Sec. 2. The agricultural emergency referred to in section 2 of Chapter 60 of the Statutes of 1933 continues to exist, and it is necessary for the same reasons that section 11 of the act cited in the title hereof was enacted to continue the section in effect until November, 1939.

Sec. 3. Nothing in this act contained shall be applicable to refunding bonds of any irrigation district issued under

or pursuant to a plan of readjustment submitted to and confirmed by any United States District Court in any proceedings under the Federal Bankruptcy Act, as amended, or any plan of readjustment submitted to and confirmed by any court of competent jurisdiction under any law of the State of California, and such refunding bonds shall be payable, as to both principal and interest, from assessments levied and collected in accordance with the terms of said bonds and the plan of readjustment pursuant to which the same are or are to be issued, anything in this act to the contrary notwithstanding. (Amended Stats. 1937 p. 491.)

This statute was originally enacted in 1931, providing relief similar to what it provides now. As quoted above, it became effective August 27, 1937. The present municipal bankruptcy act was passed August 16, 1937. (50 Stat. 654.) This proceeding was commenced June 17, 1938. (R. 8, 36.)

By amendment approved May 9, 1939, the California statute, as quoted above, was amended so as (a) to require a 50% default (instead of 20%) before invoking the statute originally, (b) to exclude from its purview all bonds issued after the date of the 1939 amendment, and (c) to extend the life of the statute to November 1, 1941.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District ~~and Reconstruction Finance Corporation~~,

Appellees.

BRIEF FOR APPELLANTS, FLORENCE MOORE, AMERICAN TRUST COMPANY, AS TRUSTEE, AND CROCKER FIRST NATIONAL BANK, AS TRUSTEE.

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Pernau-Walsh Printing Co., San Francisco

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BRIEF FOR APPELLANTS, FLORENCE MOORE, AMERICAN TRUST COMPANY, AS TRUSTEE, AND CROCKER FIRST NATIONAL BANK, AS TRUSTEE.

I.

IT IS RES JUDICATA BETWEEN THE PARTIES THAT THE CONSTITUTION FORBIDS THE GRANTING OF THE RELIEF SOUGHT.

Assignments of Error:

"No. 4. The cause is res judicata." (R. 283);

"No. 83. The Court erred in failing to find that the decree dated April 12, 1937, which is referred to in the aforesaid finding, was based upon and did directly determine that the grant of powers to readjust the indebtedness referred to * * * was in excess of the powers of Congress * * *" (R. 293).

See also Nos. 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 84, 85, 86, 87, 88, 89, 90, 91, and 92 (R. 295-300).

We now discuss the authorities establishing the proposition that the rule of *res judicata* applies to issues of law as well as to issues of fact; that questions of constitutional law and questions of jurisdiction become *res judicata* between the parties just as other issues do; that the final determination of such questions is concluded once and for all between the parties, even though that determination is later departed from; that here, therefore, the determination, in the earlier case between the parties, that the Constitution forbids the granting of the relief here sought, is *res judicata* between the parties and so determinative of this case.

(a) The Facts Relating to the Question of Res Judicata.

On May 24, 1934, the first municipal bankruptcy act was passed (48 Stat. 798, 11 U. S. C., Secs. 301-303).

In April, 1935, petitioner herein, Merced Irrigation District, filed a petition pursuant to that act in the United States District Court, seeking confirmation of a plan identical with that here involved (R. 8; Ex. OO, p. 10).

After a trial the District Court, on March 4, 1936, made its decree confirming the plan (Ex. OO, p. 275). Pending appeal to this Court, the Supreme Court of the United States decided the case of *Ashton v. Cameron County Water Improvement District No. One* (298 U. S. 513), wherein it held that the Constitution forbids the extension of the bankruptcy power to public corporations like petitioner.

Thereupon, on March 16, 1937, the appellants herein moved this Court to dispense with the printing of the record, and for a judgment of reversal, on the authority of the *Ashton* case (Ex. OO, p. 333).

The motion was granted; and on April 12, 1937, this Court made its decree reversing the decree of the District Court and directing that Court to dismiss the cause (R. 106, 89 F.(2d) 1002).

The petitioner herein, Merced Irrigation District, then petitioned the Supreme Court of the United States for a writ of certiorari (Ex. OO), which petition was denied October 11, 1937 (302 U. S. 709). Thereafter, on July 6, 1937, pursuant to the mandate of this Court (R. 962), the District Court entered its decree dismissing the cause (R. 965).

In the meantime, the present Municipal Bankruptcy Act had been passed, on August 16, 1937, as Chapter X of the Bankruptcy Act (50 Stat. 654, 11 U. S. C., Secs. 401-404). It is now Chapter IX of the Bankruptcy Act as amended by the 75th Congress, 3rd Session (52 Stat. 840, 939-40).

This new act was upheld in *United States v. Bekins,* 304 U. S. 27, decided April 25, 1938. On June 17, 1938, the present proceeding was commenced under the new statute, seeking confirmation of the identical plan confirmation of which was sought in the previous proceeding (R. 8, 36; Ex. OO, p. 10).

The Court below rejected the argument of appellants that the matter was *res judicata* (by virtue of the former adjudication), on the ground that since the prior statute was void the Courts which decided the first case were without jurisdiction to grant the relief sought, and therefore had no power to adjudicate anything, i.e., did not even have power to decide that the Constitution forbade the granting of the relief sought. The relevant part of

the opinion of the Court below appears in the record, pages 180 to 182 (*In re Merced Irrigation Dist.*, 25 F. Supp. 981).

(b) The First and Second Statutes Are Indistinguishable.

We later show that since the prior judgment rested on the proposition that the Constitution forbids scaling down the claims of these appellants against the petitioner, under color of the bankruptcy power, the present proceeding would be determined by the prior adjudication even though the new Municipal Bankruptcy Act was substantially different from the previous one.

We now point out that so far as concerns the issue finally adjudicated in the prior proceeding, the statutes are indistinguishable. We shall not set out the two Municipal Bankruptcy Acts in this brief. Both are short, and we respectfully submit that a mere reading of the two demonstrates that no substantial change in the first is made by the second. The brief filed by Mr. George Clark, as attorney for Mary E. Morris, analyzes the two statutes in detail, and shows that they are, in every essential respect, identical.

(c) The Failure of the Supreme Court in the Bekins Case to Overrule the Ashton Case Expressly Does Not Impair the Effect of the Prior Decision Between These Parties as Res Judicata.

It is a fact that the opinion in the *Bekins* case does not in terms overrule the *Ashton* case, although a careful reading of the opinion will show, we submit, that the Court intended to be understood as doing so.

In any event, it is clear that the Court cannot reasonably be taken to have held that the second bankruptcy

act differs in any essential respect from the first. After quoting from a committee report on the second Municipal Bankruptcy Act, the Court said:

> "We are of the opinion that the Committee's points are well taken and that Chapter X. is a valid enactment. The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by state law."

This language, however, cannot be taken to express the opinion that the two statutes differ, for the following reasons:

(1) The first Municipal Bankruptcy Act (Sec. 80 (k)) provided in terms that:

> "Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any political subdivision thereof in the exercise of its political or governmental powers, including expenditures therefor, and including the power to require the approval by any governmental agency of the State of the filing of any petition hereunder and of any plan of readjustment, and whenever there shall exist or shall hereafter be created under the law of any State any agency of such State authorized to exercise supervision or control over the fiscal affairs of all or any political subdivisions thereof, and whenever such agency has assumed such supervision or control over any political subdivision, then no petition of such political subdivision may be received hereunder un-

> less accompanied by the written approval of such agency, and no plan of readjustment shall be put into temporary effect or finally confirmed without the written approval of such agency of such plans." (11 *U. S. C.*, Sec. 303(k).)

In addition, Section 80(c) reads in part:

> "[the court] shall not, by any order or decree in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the taxing district." (11 *U. S. C.*, Sec. 303(c).)

The new statute expresses no more solicitude than the provisions just quoted, for the sovereignty of the states.

The provision of Section 80(k) just quoted, was quoted in full in the *Ashton* case (298 U. S. 513, 526).

(2) The above quotation from the opinion in the *Bekins* case might be taken to suggest that the Court believed the two statutes distinguishable on a second ground, namely, on the ground that by the second statute "the bankruptcy power is exercised in relation to a matter normally within its province". This could not have been the Court's intention, however, for two reasons: (1) Obviously if the second statute is within the province of bankruptcy, then the first one is; (2) in the first decision, i.e., the *Ashton* case, the Court assumed that the first bankruptcy act "is adequately related to the general 'subject of bankruptcy'" (298 U. S. 513, 527).

The fact is that the two statutes being in fact identical in substance, it would be unreasonable in the extreme to assume that the Supreme Court in the *Bekins* case held otherwise; and the only part of its opinion (quoted above) which might seem to distinguish the two statutes

has just been shown not to be susceptible of that construction.

(3) The only remaining circumstance which might suggest that in the *Bekins* case the Court meant to distinguish the later act from the earlier one, is the fact that the Court did not in so many words expressly overrule the *Ashton* case. This circumstance might be taken to support the inference that the Court regarded the two cases (and therefore the two statutes with which they dealt respectively) as being distinguishable. The inference would, we submit, be unsound, both because (in view of the considerations above discussed) it would contradict common sense, and because of the reasons now to be discussed.

The considerations which guide the Court in administering the doctrine of *stare decisis* are wholly different, and have no bearing on, the rules which govern application of the principle of *res judicata.* In the language of Mr. Justice Brandeis, "stare decisis is not, like the rule of res judicata, a universal and inexorable command" (285 U. S. 393, 405).

The Courts are, of course, free to overrule earlier decisions of which they disapprove. But the fact that an earlier decision is later departed from does not impair its effect as *res judicata* in any respect.

Frequently, because the Court has not finally determined that an earlier decision should be finally disapproved, it is thought preferable to explain or distinguish it, and to leave its final disposition as a precedent to a later time. For example, the Court often announces that an earlier decision *has been* overruled, referring to inter-

mediate decisions which did not do so in terms, but simply distinguished or explained away the earlier decision so far as necessary:

Morgan v. United States, 113 U. S. 476, 496;
Leisy v. Hardin, 135 U. S. 100, 118;
Brenham v. German Amer. Bank, 144 U. S. 173, 187;
Terral v. Burke, 257 U. S. 529, 533;
Lee v. Chesapeake & O. Ry., 260 U. S. 653, 659.

Decisions by a divided Court are considered to be of only limited authority, so far as concerns the rule of *stare decisis (Legal Tender Cases,* 12 Wall. 457, 553-554), although the fact that the Court was divided would not, of course, affect the force of the earlier decision as *res judicata,* in any manner or degree.

There is a considerable body of opinion that in the field of constitutional law, the doctrine of *stare decisis* is of much less force than it is in general. See the statement by Mr. Chief Justice Taney in *The Passenger Cases,* 7 How. 283, 470; and also the discussion and authorities in the dissenting opinions of Mr. Justice Brandeis in

State v. Dawson, 264 U. S. 219, 238;
Burnet v. Coronado Oil & Gas Co., 285 U. S. 393, 405, et seq.

See, also, the discussion and authorities in:

Erie R. Co. v. Tompkins, 304 U. S. 64, 77;
Warren, *Supreme Court in the U. S. History* (ed. 1928) II, 748-749;
Goodhart, "Case Law in England and America", 15 Corn. L. Q., 173, 179-180;
1 *Willoughby, Constitutional Law* (2 ed.) Sec. 44.

The rule of *res judicata,* on the other hand, is a very different matter. It has nothing to do with the policy of judicial administration embodied in the doctrine of *stare decisis.* It is a plain and unqualified rule of private law. In the language of the Supreme Court of the United States,

> "It is a fundamental principle of jurisprudence, arising from the very nature of courts of justice and the objects for which they are established, that a question of fact or of law distinctly put in issue and directly determined by a court of competent jurisdiction cannot afterwards be disputed between the same parties. *Southern Pacific Railroad v. United States,* 168 U. S. 1, 48." *(Frank v. Mangum,* 237 U. S. 309, 333.)

The considerations which lead the Courts to follow, or overrule, or distinguish, or ignore, or brush aside a precedent, simply have no relevancy when a prior decision is invoked as *res judicata* between the parties. The question whether the prior decree between these parties is *res judicata,* is in no way affected by the answer to the question whether or not the *Ashton* case is still a living precedent.

(d) The Presence of the Later Statute Does Not Impair the Earlier Decision as Res Judicata.

It has been recently settled that a decision under one statute is *res judicata* with respect to controversies under a later statute identical, or substantially so, with the prior enactment. This was established in

Tait v. Western Md. Ry. Co., 289 U. S. 620.

In a previous action, it had been held that the corporation in question had no right to deduct from gross

income an amortized proportion of the discount on sales of bonds by its predecessors. In this later case, it was held that the judgment worked an estoppel against the United States and the Collector in later litigation with the corporation, as to its right to make like deductions for subsequent years, under a later statute. The Court said in part:

> "The scope of the estoppel of a judgment depends upon whether the question arises in a subsequent action between the same parties upon the same claim or demand or upon a different claim or demand. In the former case a judgment upon the merits is an absolute bar to the subsequent action. In the latter the inquiry is whether the point or question to be determined in the later action is the same as that litigated and determined in the original action. *Cromwell v. County of Sac.,* 94 U. S. 351, 352-353; *Southern Pacific R. Co. v. United States,* 168 U. S. 1, 48; *United States v. Moser,* 266 U. S. 236, 241. Since the claim in the first suit concerned taxes for 1918 and 1919 and the demands in the present actions embraced taxes for 1920-1925, the case at bar falls within the second class. The courts below held the lawfulness of the respondent's deduction of amortized discount on the bonds of the predecessor companies was adjudicated in the earlier suit. The petitioner, admitting the question was in issue and decided in respect of the bonds issued by the second company, and denying, for reasons presently to be stated, that this is true as to the bonds of the first company, contends that as to both the decision of the Court of Appeals is erroneous, for the reason that the thing adjudged in a suit for one year's tax cannot affect the rights of the parties in an action for taxes of another year. * * *

> "This court has repeatedly applied the doctrine of *res judicata* in actions concerning state taxes, holding the parties concluded in a suit for one year's tax as to the right or question adjudicated by a former judgment respecting the tax of an earlier year. *New Orleans v. Citizens' Bank,* 167 U. S. 371; *Third National Bank v. Stone,* 174 U. S. 432; *Baldwin v. Maryland,* 179 U. S. 220; *Deposit Bank v. Frankfort,* 191 U. S. 499. Compare *United States v. Stone & Downer Co.,* 274 U. S. 225, 230-231. The public policy upon which the rule is founded has been said to apply with equal force to the sovereign's demand and the claims of private citizens."

The earlier decision referred to by the Court above had been decided under the Revenue Act of 1918, whereas the *Tait* case itself arose under the Revenue Acts of 1921 and 1924. This was held not to impair the applicability of the doctrine of *res judicata,* since the question of law decided in the first case was conclusive in the second. There, as here, it was argued that the new statute created a new right; but the legal question determined in the first case being determinative of the second, was held to conclude the parties.

Another case in which adjudication under an earlier statute was held *res judicata* under a later statute (discussed and quoted at length below) is

Gunter v. Atlantic Coast Line, 200 U. S. 273.

(e) Even Had the Second Municipal Bankruptcy Act Differed Substantially from the First, the Rule of Res Judicata Would Control.

It is, of course, settled that there are two aspects of the doctrine of *res judicata:* First, an earlier judgment

is absolutely conclusive in a later action involving the same cause of action, both as to issues actually tried and as to all matters that might have been tried. Secondly, an earlier judgment is conclusive between the parties in a later action (even though the later action is based on a wholly different cause of action) as to any issue of law or fact adjudicated in the earlier action.

See *Tait v. Western Md. Ry. Co., supra,* and the cases discussed next below.

A necessary corollary of this rule is that where an issue of fact or law previously adjudicated between the parties is, if applied, of controlling significance in a later action between them, it makes no difference that the cause of action asserted in the second case was created by a later statute.

The case now to be discussed so holds; and is, we submit, indistinguishable from the case now before this Court.

Gunter v. Atlantic Coast Line, 200 U. S. 273:

The charter of the railroad corporation involved, as amended in 1863, exempted its property from taxation. A statute of the state of incorporation (South Carolina) was nevertheless passed in 1868 attempting to subject the railroad's property to taxation. This statute was held void, as an impairment of the obligation of contract, by the Supreme Court of the United States, in 1872 (16 Wall. 244).

In 1900 the state enacted another, and quite different, statute providing for the taxation of the property of this railroad, and others with similar charters. This statute, as described by the Court (p. 289),

> "created a board to make the assessment to which it referred, limited the taxes to be imposed to ten years back, provided that the assessment made by the board should be put upon the rolls separately for each of the back years, and that there should be levied upon such assessment state and county taxes for the years to which the back assessment related. The act caused the taxes for which it provided to become a lien against the property upon which they might bear, and directed a certification of the taxes as assessed and levied to the respective county treasurers, and made it their duty to collect the same. To this end such treasurers were directed to make a demand for payment upon the company in whose name the assessment was made, or, if it was found that the property assessed was 'in the control of another company, demand shall be made of the company * * * in possession of the property.' By the act, in addition, the Attorney General was directed, if the back taxes assessed were not paid within sixty days after demand, to bring a suit in the name of the State, with the cooperation of such counsel as the counties might employ, to enforce the collection of the back taxes against the company in whose name they were assessed or against the company found in possession of the property assessed."

This proceeding was brought to enjoin the imposition of taxes under the new statute. The Court held that the matter was *res judicata* under the decision of 1872. And this notwithstanding the fact that the present attempt to tax was under the authority of a statute passed years after the decision of 1872, and related to taxes for later years, constituting therefore a completely new and different cause of action from that adjudicated in 1872. The Court said in part (p. 290):

"* * * That the issue in the case was the existence of a charter exemption from taxation in favor of the Cheraw and Darlington Railroad Company, and the consequent want of power of the State to tax the property of the railroad during the continuance of the exemption, is obvious. And that the decree rendered in the cause established the exemption embraced in the issues is also obvious. This being true, it unquestionably follows that the decree established as to the parties and their privies the very question in issue in this proceeding. * * *

"It is urged that as the taxes, the collection of which the court enjoined, were not for the same years as were the taxes with which the Pegues case was concerned, the Pegues decree was, therefore, not *res judicata,* because it related to a different cause of action. This rests upon the assumption that a decree enjoining the collection of a tax for one year can never be the thing adjudged as to the right to collect taxes of a subsequent year. But the proposition entirely disregards the fact that the decree in the Pegues case, enjoining the collection of the taxes in controversy in that case, was rested upon the ground that there was a contract protected from impairment by the Constitution of the United States which was as controlling on future taxes as it was upon the particular taxes to which the Pegues suit related."

In numerous cases the Supreme Court of the United States has held decisions on questions of law concerning taxes for a particular year to be *res judicata* in actions involving different taxes for later years. Now the levy of taxes is, of course, a purely legislative act:

Cooley on Taxation, Secs. 1012, 1013;

Heine v. Board, 19 Wall. 655;

Meriwether v. Garrett, 102 U. S. 472;
Taylor v. Secor, 92 U. S. 575.

Obviously, a levy of taxes for one year is a separate, distinct and independent legislative act from levies concerning later years. These cases, therefore, further support the proposition that the presence of a later enactment, which is the ground of the action brought, does not in any way impair the applicability of the doctrine of *res judicata* if an issue of law previously adjudicated between the parties is (as here) conclusive of the controversy. A discussion of these cases now follows:

New Orleans v. Citizens' Bank, 167 U. S. 371:

In previous actions, it had been held that the charter of the bank in question exempted it from certain taxes. This action involved similar taxes for subsequent years. The previous judgments were here held conclusive of the question whether the bank's charter created the exemption. The Court said in part, quoting with approval from other cases:

> "'Matters once determined in a court of competent jurisdiction may never again be called in question by parties or privies against objection, though the judgment may have been erroneous and liable to, and certain of, reversal in a higher court.' Bigelow Estoppel, 3d ed., Outline, pp. lxi, 29, 57, 103." (p. 398.)
>
> "'It is undoubtedly true that the taxes of each year ordinarily constitute separate and distinct rights or causes of action. But where an action is brought to recover taxes paid in one year, and an action is afterwards brought to recover for the taxes paid in a subsequent year, and the adjudication in the first is pleaded as a bar to the recovery in the second

action, the question whether the estoppel is effectual will depend upon the issues in the two actions.

"'If the right to recover and the defence thereto are based upon precisely the same ground, why litigate again the question that has been determined? In such case the very right of the matter has been determined by a court of competent jurisdiction. It is not essential that the causes of action should be the same, but it is essential the right or title should be; that is, the issues in both actions and the matter on which the estoppel depends must be the same, or substantially so." (pp. 400, 401.)

To the same effect are the numerous cases cited in *Tait v. Western Md. Ry. Co.,* 289 U. S. 620, at page 624. The *Tait* case has already been discussed and quoted at length.

Forsyth v. Hammond, 166 U. S. 506:

In this case, plaintiff's land was incorporated into a city by means of a judicial proceeding authorized by statute. Plaintiff appealed to the State Supreme Court, arguing that such incorporation was a legislative function, and could not constitutionally be accomplished in a judicial proceeding. The judgment was affirmed, however, and became final. Later plaintiff brought this proceeding to enjoin collection of a tax by the city, setting up the same contention that the judicial incorporation of her property into the city was void. The Court here held that the previous decision was *res judicata.* The Court said (p. 517):

"* * * But after an adverse decree she insisted that it was not only erroneous but void, and voluntarily commenced an action in the Supreme Court of the State to have that claim established. She

invoked the jurisdiction of that court. She summoned the city of Hammond into that forum and there challenged the decree of the Circuit Court, challenged it for error and also for lack of jurisdiction. The questions both of error and of jurisdiction were certainly judicial in their nature and questions within the undoubted cognizance of the Supreme Court. She voluntarily sought its judgment. Can she, after its decision, be heard in any other tribunal to collaterally deny the validity thereof? Does not the principle of *res judicata* apply in all its force? Having litigated a question in one competent tribunal and been defeated, can she litigate the same question in another tribunal, acting independently, and have no appellate jurisdiction? The question is not whether the judgment of the Supreme Court would be conclusive as to the question involved in another action between other parties, but whether it is not binding between the same parties in that or any other forum. The principles controlling the doctrine of *res judicata* have been so often announced, and are so universally recognized, that the citation of authorities is scarcely necessary. Though the form and causes of action be different, a decision by a court of competent jurisdiction in respect to any essential fact or question in the one action is conclusive between the parties in all subsequent actions. *Cromwell v. Sac. County,* 94 U. S. 351; *Lumber Co. v. Buchtel,* 101 U. S. 638; *Stout v. Lye,* 103 U. S. 66; *Nesbit v. Riverside Independent District,* 144 U. S. 610; *Johnson Co. v. Wharton,* 152 U. S. 252; *Last Chance Mining Co. v. Tyler Mining Co.,* 157 U. S. 683."

See, also,

Cromwell v. The County of Sac., 94 U. S. 341, 359;
Deposit Bank v. Frankfort, 191 U. S. 499.

In the next subdivision hereof, we show that the issues determined in the earlier case between the Merced Irrigation District and appellants are determinative of the present case.

(f) It is Res Judicata Between the Parties that the Constitution Forbids the Granting of the Relief Here Sought.

As shown above, in the earlier case involving the plan here involved, the decision was ground solely on the authority of *Ashton v. Cameron County Improvement District No. One,* 298 U. S. 513. The ground of the previous decision between these parties was therefore identical with the ground of the decision in the *Ashton* case; and appears unequivocally in the Supreme Court's opinion, from which we quote briefly:

> "We need not consider this Act in detail or undertake definitely to classify it. The evident intent was to authorize a federal court to require objecting creditors to accept an offer by a public corporation to compromise, scale down, or repudiate its indebtedness without the surrender of any property whatsoever. * * *
>
> "Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. * * *
>
> "The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify or impair the obligation of their contracts. The statute before us expresses this design in plain terms. It undertakes to extend the supposed power of the Federal Government incident to bankruptcy over any embarrassed district which may apply to the court. * * *

"Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. *United States v. Butler,* decided January 6, 1936, 297 U. S. 1. The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation. See *United States v. Constantine,* 296 U. S. 287. * * *

"* * * for a very long time this court has steadfastly adhered to the doctrine that the taxing power of Congress does not extend to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause. *United States v. Butler, supra.*"

It thus appears beyond rational dispute that the *Ashton* case turned, not on any detailed provision in the first Municipal Bankruptcy Act but on the interpretation of the Constitution of the United States.

That instrument was unequivocally held to forbid bankruptcy legislation designed to impair the obligation of contracts of public corporations like petitioner herein. That issue, now being *res judicata* between the parties before this Court, necessarily requires the conclusion that the Court below should have dismissed the bill.

II.

THE PETITIONER OWES THE RECONSTRUCTION FINANCE CORPORATION $9,500,000.00 LESS THAN IT CLAIMS TO OWE THAT CORPORATION.

IT FOLLOWS:

(a) That Petitioner is Entirely Solvent and Able to Meet its Debts as they Mature.

(b) That the RFC is Not Affected by the Plan, and Cannot, Therefore, Effectively Consent to it.

(c) That the RFC is in a Different Class of Creditors From That Constituted by Appellants.

Assignments of Error:

"21. The Court erred in finding and holding that the Reconstruction Finance Corporation is the owner or holder of the original bond issues of the Merced Irrigation District entitled to vote on the plan of composition herein." (R. 285).

"No. 20. The Court erred in finding and holding that the Reconstruction Finance Corporation is a creditor affected by the plan." (R. 285).

See also Nos. 9, 14, 15, 19, 24, 28-31, 53.

Appellants contend that under the contract between petitioner and Reconstruction Finance Corporation (hereinafter called the RFC):

(a) The bonds of the district surrendered to the RFC by former bondholders are now held by the RFC as pledgee. The total principal amount of the bonds so held is $14,686,000 (R. 32).

(b) The beneficial ownership of these bonds is in the district, subject to the rights of the RFC, as pledgee, to realize therefrom the amount owing to the RFC if the petitioner defaults in payment.

(c) The total amount owing to the RFC is $7,570,-871.60 (R. 888), that being the total amount disbursed by the RFC.

The district, on the other hand, contends that it owes the RFC the total amount of bonds held by that corporation, i. e., $14,686,000, with unpaid interest (R. 17).

Two exhibits herein show the difference between the positions of the parties (Ex. Z, R. 886; Ex. AA, R. 887-888). These exhibits show that if the bonds held by the RFC are in fact owing by the district, the total bonded indebtedness, including unpaid interest, is $20,273,919. If, on the other hand, as appellants contend, the total amount owing to the RFC is simply the amount disbursed by that corporation, the total bonded indebtedness of the petitioner, plus the amount advanced by the RFC to take up old bonds, is in the aggregate $10,743,552.62. The parties, therefore, disagree concerning the total indebtedness of petitioner arising out of the bond issues here in question, and that difference amounts to $9,530,-366.38. As shown by Exhibit AA just mentioned, it is admitted that if appellants' contention is correct concerning the effect of the RFC contract, then the petitioner, far from being in financial difficulties, has a capital surplus of $10,743,525.62. This figure takes account of all of the assets and liabilities of petitioner, whether arising out of its bond issues or otherwise (R. 887-888). But it takes no account whatever of the value of the privately owned lands in the district.

It becomes important, therefore, to decide the controversy between the parties on this question, which actually consists of two questions:

1. What in fact is the debt owing by petitioner to the RFC as between those parties, i.e., as between the debtor and the creditor?

2. If, as appellants contend, the amount of that debt is simply the amount the RFC has disbursed, then a second question arises, namely, does the statute permit or require that the RFC be treated, for the purposes of this proceeding, as owing the RFC $9,500,000 more than the amount actually owing, namely, the full amount of the old bonds (with interest) surrendered to and now held by the RFC?

(a) As Between Petitioner and RFC, the Debt of Petitioner to RFC is Only the Amount of the RFC Loan.

In the main brief of appellants herein (under the heading "First Proposition"), it is, we believe, demonstrated that it would be unthinkable for any court to hold, as between the RFC and the petitioner, that the petitioner owed the RFC the face amount of the bonds held by it. It is, on the contrary, shown, we submit, that the total amount owing to the RFC by the petitioner is the amount of the RFC's advances to the district or on its behalf. We shall mention only briefly a few of the almost countless authorities which call for this conclusion.

Preliminarily, the loan contract between the RFC and the petitioner is, by its own terms, governed by California law (Ex. OO, p. 216).

In California, as elsewhere, the authorities show that, for literally a dozen reasons, the contract here involved is a pledge and not a purchase.

It is, of course, well settled that a transfer from a third party directly to the creditor has the same effect as a transfer from the debtor to the creditor so far as concerns the question whether the transfer is a purchase

and sale, or is a transfer merely as security. *Rosemead Co. v. Shipley Co.,* 207 Cal. 414, 422, and authority there cited.

It matters not, therefore, that in this case the bonds passed to the RFC, not from the District but from third persons.

The following sections of the Civil Code should be noted:

> *Sec. 2924.* Every transfer of an interest in property, other than in trust, made only as a security for the performance of another act, is to be deemed a mortgage, except when in the case of personal property it is accompanied by actual change of possession, in which case it is to be deemed a pledge. * * *
>
> *Sec. 2888.* Notwithstanding an agreement to the contrary, a lien, or a contract for a lien, transfers no title to the property subject to the lien.
>
> *Sec. 2889.* All contracts for the forfeiture of property subject to a lien, in satisfaction of the obligation secured thereby, and all contracts in restraint of the right of redemption from a lien, are void.

It is apparent from these sections alone, not to mention the authorities later discussed, that the policy embodied in these statutes applies without distinction to mortgages and pledges. For the sake of brevity, we now quote several excerpts from the article on mortgages in California Jurisprudence, which set out well-settled principles of law:

> "It is accordingly the settled policy of equity *never to permit a security to be converted by any contemporaneous agreement into a sale.*" (17 Cal. Jur. 742.)

"The only difficulty in most cases is to ascertain *whether a debt subsists* or has been extinguished, and *when there is doubt on this point* as affecting the question as to whether the instrument is a conditional sale or a mortgage, *courts of equity lean in favor of the right of redemption.*" (17 Cal. Jur. p. 742.)

"If at the time a deed is executed it is intended merely as security for a debt, it follows as a matter of law that it is a mortgage, *regardless of any intention or stipulation that it shall be something else.*" (17 Cal. Jur. p. 743.)

"That the grantee is mistaken as to the legal effect of the deed, however, does not change the rights of the parties, and the fact that he testifies that in his opinion the instrument is not a mortgage is immaterial." (17 Cal. Jur. p. 743.)

"If the transfer is in fact made as security, it is in equity a mortgage *irrespective of the form in which it is made,* and *no matter how expressly the parties may agree that it shall not be so deemed,* and no matter how strong the language of the deed or any instrument accompanying it may be. *No form of words, however adroitly used to conceal the purpose* of security can estop the grantor from pleading and proving the fact, for *it is not a matter of contract but of law.* It is the real character, not the form of the instrument, to which the court will look." (17 Cal. Jur. p. 745.)

"* * * If a consideration is a pre-existing debt or a present advance of money and *the relation of debtor and creditor remains, the conveyance must be treated in all respects as a mortgage.*" (17 Cal. Jur. pp. 783-784.)

"The fact that interest is to be paid upon the amount of money received for the deed is *very strong circumstance* tending to show that the transaction is a loan, *such obligation being inconsistent with the theory that the grantee is absolute owner.* So the fact that the grantee charged his vendor annually with interest upon the whole of the purchase money which he paid, *which interest he received year after year,* is strong evidence that the transaction was a mortgage." (17 Cal. Jur. pp. 786, 787.)

"The following circumstances tend to prove a deed to be a mortgage; payment by the grantor of charges of recordation; language in the instrument respecting 'foreclosure'; statements by the grantee in letters speaking of the property as being 'mortgaged' or 'encumbered', and an agreement giving the grantor a right to redeem." (17 Cal. Jur. pp. 795, 796.)

The following quotation is taken from the article on Pledges contained in the same treatise:

"Notwithstanding the transfer of property purports to be absolute, if made as security in truth and in fact, it may and will be held to be merely a pledge." (21 Cal. Jur. pp. 292, 293.)

The case of *Shelley v. Byers,* 73 Cal. App. 44, is a case identical in principle, we submit, with the present one. We commend it to the Court's attention.

Under the authorities above discussed, transactions like that between the RFC and petitioner are uniformly construed as contracts of loan rather than purchase on the basis of *any one* of numerous factual circumstances. As shown in the main brief of appellants herein, *all* of the

grounds taken count of by the Courts as *singly* establishing the existence of a security transaction are present in the case now before this Court.

(b) No Provision in the Statute Permits Debts That Have Been Extinguished to be Treated as Still Existing For Any Purpose.

The only provision in the Municipal Bankruptcy Act which might be even plausibly argued to be relevant to the question is the part of Section 82 reading as follows:

> "Any agency of the United States holding securities acquired pursuant to contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof." (11 U. S. C. 402.)

The only other provision which could be argued to have the effect just stated in the heading is subdivision (j) of section 83 (11 U. S. C., Sec. 403(j)). That provision is inapplicable primarily for three reasons:

(a) It is limited expressly to cases in which refunding bonds have been issued. None have been issued here.

(b) It does not purport to allow holders of the refunding bonds to vote, or otherwise act as, creditors beyond the amount of the refunding bonds held.

(c) Although it applies to refunding bonds issued before the filing of the petition, it does not purport to operate retrospectively.

We submit that the provision just quoted furnishes no authority for the contention of the petitioner. Petitioner must argue, in order to succeed in this proceeding, that

although in fact the district's debts had been reduced, by more than $9,500,000 prior to the enactment of the Municipal Bankruptcy Act, it is nevertheless to be held that those former debts are to be revived for the purposes of this proceeding; and that upon that basis, it is to be held that the district needs the relief sought because (as is contended) it cannot pay its present debts plus its former debts.

The provision will not support the contention, for the following reasons:

1. Even if applicable here, it does not so provide;

2. The provision is inapplicable, since the transaction occurred years before it was enacted. In other words, the debts of the petitioner had been reduced by a completed accord and satisfaction nearly two years before the statute was passed.

The Statute Does Not So Provide.

(a) The provision quoted does not even suggest that it is intended to dispense with the requirement that any creditor whose consent is to be taken account of must be affected by the plan. And for a creditor to be affected by the plan, the plan must be such that his "rights * * * are proposed to be adjusted or modified materially". Here, the rights of the RFC are not adjusted or modified by the plan at all, whether materially or otherwise.

(b) For the statute to operate at all, 51% (in amount) of the creditors affected by the plan must consent initially, and two-thirds must consent before the plan may be confirmed, "excluding, however [in both cases], any securities owned, held, or controlled by the petitioner." (Sec.

83 (a), 83 (d).) This language excludes pledged securities from those whose consent may be counted, since they are owned by the pledgor (petitioner), the pledgee having only a lien:

> "The general rule that notwithstanding any agreement to the contrary a lien or a contract for a lien transfers no title to the property subject to the lien, is applicable to pledges." (21 Cal. Jur. 328.)

This language is quoted and applied in

Western Mortgage etc. Co. v. Gray, 215 Cal. 191, 201;

Bank of America etc. Ass'n Figueroa, 218 Cal. 281.

See also the many cases cited in California Jurisprudence, *supra.*

(c) By Section 83 (b) of the Bankruptcy Act:

> "The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors."

Under this provision, the RFC is in a different class of creditors from appellants, for at least two reasons:

(1) By the contract between petitioner and RFC, the petitioner pledged the revenues to be received from power,

> "in each calendar year commencing January 1, 1936 except the first $100,000 thereof and except any amount in excess of $575,000 in each such calendar year * * *"

The petitioner agreed that,

> "such allocation shall be irrevocable." (R. 209, 210).

Thus, in the language of the statute, RFC is "the holder of a claim for the payment of which specific property or revenues are pledged".

(2) As shown above, the RFC is also pledgee of $14,686,000 of old bonds to secure payment of its loan.

It is to be observed that even though the provision of the statute quoted above were given all mechanically possible effect (i. e., even though the RFC were considered to be in fact, and for all purposes, a creditor of the petitioner to the full amount of the old bonds held by it), the RFC's consent would still be inoperative against appellants, since undeniably specific revenues are pledged to it, namely, the power revenues, not to mention the old bonds.

(d) The statute (quoted above) says that any agency of the United States holding securities acquired pursuant to contract with any petitioner shall be deemed a "creditor" in the amount of the "full face value thereof." But "creditor" has a peculiar meaning as here used. It is defined in the same section of the statute as follows: "The term 'creditor' means the holder of a security or securities." (11 U. S. C., Sec. 403.)

Now a pledgee is, of course, a "holder" of the securities held in pledge. But the pledgee's status as a holder does not increase the debts of the pledgor, even though the securities held in pledge are the pledgor's own obligations.

The law on this question appears to be fairly clear. Although the transaction is anomalous, it appears to be settled that a debtor may pledge his own bonds: As se-

curity for his promise to pay $1,000, a debtor may pledge an instrument which is simply another promise by him, to pay another $1,000. When it does so, the pledgee may realize on (i.e., obtain a judgment upon) the pledged promise, in addition to obtaining a judgment on the main promise, as security for which the instrument was pledged. But the pledgee may, of course, obtain only one satisfaction, that is to say, may actually collect only the amount actually owing.

Anglo-California Trust Co. v. Oakland Railways, 193 Cal. 451;

Murphy v. Murphy, 74 Conn. 198.

In the event of bankruptcy proceedings, moreover, the only amount which the pledgee may prove is the amount owing on the actual debt.

Sauve v. Fleschutz, 219 Fed. 542;

Butterfield v. Woodman, 223 Fed. 956;

In re Sullivan Condensed Milk Co., 291 Fed. 66.

Taking account of this rule, we submit that the provision of the Municipal Bankruptcy Act under inquiry (providing that a public agency holding securities pursuant to contract with the petitioner shall be deemed a "creditor", i.e., a holder, in the amount of "the full face value thereof"), should be taken simply to codify the rule just discussed.

In other words, the provisions should be taken to mean that a public agency which makes a loan in aid of a refinancing scheme, taking the old bonds surrendered as security for its loan, shall have the remedies of any holder of bonds for the purpose of insuring repayment of its loan.

There is one other construction which might rationally be given to the provision in question. There is some authority (although it is not now generally accepted) that a pledgee of an insolvent debtor's own securities is entitled to a proportion of its assets equal to the proportion of its securities held in pledge, even though that is more than the proportion of its actual debts held by the pledgee. See *Barry v. Mo. K. & T. Ry. Co.,* 34 Fed. 829. In that case a railway company which had outstanding an issue of bonds that were a lien on income, issued general refunding mortgage bonds to take up the income bonds. Under the plan, interest on the old bonds (i.e., the income bonds) was not to be paid in full but by new bonds equal in amount to 60% of the face value of the interest coupons. Some of the old bonds were exchanged and some were not. This was a proceeding requiring the Company to account for and pay over accumulated income to the persons entitled thereto. The Court held that the holders of old income bonds who had not surrendered them were entitled only to the *same proportion* of this income as they would have been entitled to if none of the income bonds had been surrendered. The refunded old bonds had been surrendered to a trust company as trustee, and were (as we say is the case here), "held uncancelled *as security* for the new bonds."

If the provision of the Municipal Bankruptcy Act in question were given this effect, then, in the distribution of any fund of a petitioner available to creditors, the RFC would be entitled to a proportion thereof equal to the proportion of the original bonded indebtedness of petitioner represented by the old bonds held in pledge

by it. It would be so entitled, however, only up to the amount actually owing to the RFC.

Anglo-California Trust Co. v. Oakland Railways, 193 Cal. 451, and other cases cited above.

Whichever of these interpretations is adopted, it is clear that for purposes of determining whether the district needs the relief sought, the statute does not permit or require that question to be answered on the fictitious assumption that the whole amount of the district's old bonds, with interest, is still owing.

No Rational Purpose Would be Accomplished by Construing the Statute as Reviving the Cancelled Debts For Any Purpose.

The Municipal Bankruptcy Act, like the other composition sections, requires the consent of a percentage of creditors before the plan may be confirmed. We submit as unquestionable that for a "consenting" creditor to be a "creditor" capable of consenting as a member of the same class as objecting bondholders, the consenting bondholder must preserve his status as a creditor who will be affected by the plan. In other words, his consent must be conditional upon the plan's being carried out under the statute. If, instead of consenting to the plan within the meaning of the statute, a bondholder enters into an accord and satisfaction, i.e., accepts less than the amount due in full satisfaction of the debt owing to him and represented by the bond, he thereby irrevocably accepts a status different than that of other bondholders. It was so held flatly in the case of

In re City of West Palm Beach (C. C. A. 5th), 96 F. (2d) 85.

This case is precisely in point; and (we submit) is clearly sound.

The opinion therein is short and we earnestly commend it to the Court's attention. The Court said in part (p. 86):

> "* * * The owners of these were no longer acceptors of an executory plan, but had been fully settled with under it and no longer had any direct interest in it. They could not fairly be counted as voters before the court on the propriety of the plan. Of course they would wish the nonacceptors to be forced to scale their debts as they themselves had done. They could no longer have an open mind as to whether, in the light of developments, the plan was a good one or a bad one. The binding of a minority by a majority having the same interests was discussed as respects corporate reorganizations in Texas Hotel Securities Co. v. Waco Development Co., 5 Cir., 87 F. 2d 395, and Continental Ins. Co. v. Louisiana Oil Ref. Corp., 5 Cir., 89 F. 2d 333. The importance of identity of interest is there stressed. We do not think the creditors of West Palm Beach who have already irrevocably scaled their debts can be counted either in the two-thirds finally to be needed, nor as preliminary acceptors of the scaling plan offered as a composition."

We submit that no other conclusion is possible than that reached by the Court in the *West Palm Beach* case.

The fact is, and this Court may doubtless take judicial cognizance thereof, that the usual means of effecting compositions under the bankruptcy act is for consenting

creditors to consent to the plan on condition that it is carried out.

There is no difficulty for the RFC to participate in this manner. If its purpose at the time it makes a loan is to maintain the status of the surrendered bonds as those of consenting creditors within the meaning of the act, it may, and does in fact, simply postpone disbursement of the loan until a decree confirming the plan has become final. An example is the case of *Covell v. Waterford Irrigation District,* a proceeding under the first Municipal Bankruptcy Act, reported in 86 F. (2d) 52. Doubtless the records of this Court will show the fact that no disbursement was made in that case, and indeed none has yet been made.

The fact is, therefore, that no rational purpose would be served by announcing the astonishing proposition that the provision of the Municipal Bankruptcy Act quoted above has the effect that a petitioner owing $10,000,000 may scale down its debts as if it owed $20,000,000.

In Any Event, the Provision Making Public Agencies Creditors For "Full Face Value" is Inapplicable, Under the Rule Against Retrospective Interpretation.

There is, of course, a general rule that statutes are not construed as intended to be retrospective in operation unless intention that they shall so operate is unequivocally expressed. Speaking of the rule that statutes are never construed to operate retrospectively unless clearly intended, Mr. Justice Story spoke as follows in a much cited case:

"Is it confined to statutes, which are enacted to take effect from a time anterior to their passage, or does it embrace all statutes, which, though operating only from their passage, affect vested rights and past transactions? * * *

"It would be a construction utterly subversive of all the objects of the provision, to adhere to the former definition. * * * Upon principle, every statute, which takes away or impairs vested rights acquired under existing law, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations already past, must be deemed retrospective." (*Society v. Wheeler,* 2 Gall. C. C. 105, 139.)

This rule, of course, applies to bankruptcy statutes as to others.

Holt v. Henley, 232 U. S. 637;

Arctic Ice Machine Company v. Armstrong County Trust Co., 192 U. S. 114;

In re Shorer, 96 Fed. 90;

In re New Amsterdam Motor Co., 180 Fed. 943.

It is also, of course, well settled that where, as here, retrospective interpretation would raise grave questions of constitutionality (*Holt v. Henley,* supra) that construction will, if it is possible to do so, be avoided.

Reinecke v. Northern Trust Co., 278 U. S. 339;

Bell Telephone Co. v. Nebraska State R. Co., 297 U. S. 373;

Interstate Commerce Commission v. Oregon-Washington R. & Nav. Co., 288 U. S. 14;

George Moore Ice Cream Co. v. Rose, 289 U. S. 373.

Concluding this point we submit that the following propositions are established:

(a) Since petitioner's debt to the RFC consists only of the amount of the RFC loan, the petitioner's total debt is nearly $10,000,000 less than petitioner claims it to be.

(b) It follows that petitioner is entirely solvent and able to meet its debts as they mature. There is no contention in this case that the petitioner needs any relief unless it persuades the Court to hold that its debt to the RFC is the total amount of bonds held by that corporation ($14,686,000) with unpaid interest.

(c) That since the RFC is to receive, under the plan, every cent owing to it, that corporation is not affected by the plan.

(d) That since the RFC is to be paid in full (and has other security for payment, namely, the power revenue), it is in a different class of creditors from the nonconsenting bondholders.

In essence the district's contention amounts to this: that since some two years ago (long before the statute was passed which is the basis of this proceeding), a large number of the old bondholders of petitioner chose voluntarily and irrevocably to accept 51.501 cents on the dollar in full satisfaction of their claims, appellants should be compelled to do the same. We respectfully submit that no considerations of justice suggest any such conclusion; and certainly nothing in the statute would justify a decision to that effect.

CONCLUSION.

For the reasons above stated and for the other reasons stated in the main brief of appellants herein, we submit that the judgment of the Court below should be reversed with directions to dismiss.

Dated, San Francisco,
October 16, 1939.

Respectfully submitted,
HERMAN PHLEGER,
BROBECK, PHLEGER & HARRISON,
Attorneys for Appellants, Florence Moore, American Trust Company, as Trustee, and Crocker First National Bank, as Trustee.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District and ~~Reconstruction Finance Corporation,~~

Appellees.

BRIEF FOR APPELLANT MARY E. MORRIS ON ISSUE OF RES JUDICATA.

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BRIEF FOR APPELLANT MARY E. MORRIS ON ISSUE OF RES JUDICATA.

STATEMENT OF THE CASE.

The Court granted permission to appellant, Mary E. Morris, to file on behalf of the appellants in the above cause this separate brief on the issue of *res judicata.*

The assignments or designations of error on the point are quoted in an Appendix, pages i to iv.

Appellants are bondholders of respondent, Merced Irrigation District.

(Throughout the italics are ours.)

The judgment relied on is a judgment of this Court which reversed a judgment of the United States District Court on the ground that *the grant of judicial power* under which the latter Court had acted in entering a decree which impaired the obligations of the bonds held by the appellants was outside the bankruptcy clause of the Constitution and on that ground void. This Court's judgment directed the District Court to dismiss the prior proceeding. The latter Court entered its decree accordingly.

This cause involves the same bonds and it involves *an identical grant of Federal judicial power* and an attempt to base such grant upon the same provision of the Constitution. And the new grant is made in the same terms and for precisely the same purpose and it has resulted in precisely the same decree.

As the rule of *res judicata* applies to determination of questions of law; to the construction of the Constitution itself, to the validity of all grants of power; whether administrative or judicial, appellants here contend that the question of construction of the Constitution answered in the first proceeding is decisive of the same question in this second proceeding.

> Complete references to the evidence in support of the plea are set out in the Appendix, pages iv to ix.
>
> Much of this evidence is contained in Respondents' Exhibit "OO", a printed Transcript of the record on the appeal to this Court in the prior proceeding. Owing to the decision in the *Ashton* case hereinafter referred to, this Court dispensed with the printing of the said record, but the record

was printed on an application of the respondent District to the Supreme Court for certiorari, which application was denied. (In the trial court the appellants here were designated respondents. Hence the said exhibit designation.)

For the Court's convenience, we, at the end of this opening Statement, quote the terms of the two grants of judicial power involved and also show the Court made the same determinations and the same decree in the two causes.

It will be noted that in legal history no precedent can be found for what is here involved—an attempt to avoid a judgment that a Federal United States District Court cannot be given power to impair in bankruptcy the public obligations of an agency of a sovereign state, by obtaining from the same authority, Congress, an act containing another grant of the same judicial power. Not even different words were used in making the second grant of power.

The Supreme Court makes it clear in the following case that the rule of *res judicata* applies to grants of judicial power.

Stoll v. Gottlieb, 305 U. S. 165, 83 L. ed. (Adv. Sheets) p. 116.

The Supreme Court held in that case that a certain final order made in a federal bankruptcy proceeding had conclusively adjudicated that the District Court had jurisdiction. The question involved was one of law appearing on the face of the record.

We do not contend at all that the rule of *res judicata* applies to mere questions of judicial procedure or that

a litigant can acquire a vested right as against his adversary to have every cause that arises between the two parties erroneously tried. That is not this case. Merced Irrigation District brought the prior proceeding to readjust its obligations upon the identical bonds held by these appellants. These appellants claimed that it was not competent for Congress, acting under the bankruptcy clause of the Constitution to grant *Federal judicial power* to a United States District Court to discharge those bonds by fastening a new type of debts on the district, because those bonds are public obligations or obligations of an agency of a sovereign State; that they were therefore immune from the attempted impairment. This Court so held. And it further held and necessarily held that the State could not invite, or consent to, the exercise of the power because of the contract clause. As is shown in the case of *United States v. Moser,* 266 U. S. 236, 69 L. ed. 262, any question of law becomes *res judicata,* when it involves the application of a particular statute to a particular demand or a demand of the same identical kind, even though the causes of action are different. For the purpose of the rule suits for separate installments due under the same contract are different causes. In the case cited, the plea in Moser's favor was sustained. One of the cases cited by the Government dealt with a prior adjudication that the terms of a statute, coupled with what had been done under it by one, Boyd, constituted a contract and Boyd pleaded *res judicata;* but it appeared that in the prior proceeding, which was treated as being upon a separate cause, the constitutionality of the statute was not passed upon or in any

manner determined and hence the plea was not sustained. This objection was raised in the second proceeding. The Supreme Court said:

> "Courts seldom undertake, in any case, to pass upon the validity of legislation, where the question is not made by the parties. Their habit is to meet questions of that kind when they are raised, but not to anticipate them. * * * Previous adjudications upon other points do not operate as an estoppel against parties *in new causes,* nor conclude the court upon the constitutionality of the Acts, because that point might have been raised and determined in the first instance."
>
> *Boyd v. Alabama,* 94 U. S. 645, 24 L. ed. 302.

But obviously had the constitutionality of the law been raised in the first cause, the determination would have bound in the second cause.

Note at once that Moser's prior judgment was upon a different cause of action, but the legal question was one of right under a statute that determined the second cause if it determined the first. The two causes of action were as separate as are suits upon different bonds of the same issue. In such a case, the prior judgment does not bind except as to questions actually raised and determined.

> *Nesbit v. Independent Dist. of Riverside,* 144 U. S. 610, 36 L. ed. 562.

But the Supreme Court, in the case of *United States v. Moser* clearly recognized the rule that if the question of law arises in the first case and is determined, it is as if a relevant question of fact has been determined.

Note that the *Boyd* case said that the constitutional question was not involved. Note the effect of the judgment invoked in the following case which supplied that omission. The question was, whether a bank's charter exempted it from certain taxes for the period of the charter. Of the answer in the first case, the Court said:

> "The answer besides averred that the clause of the charter exempting the bank from taxation *was in violation of the constitution* of the state of Louisiana of 1812, in force at the time the charter was granted, and that it also violated subsequent constitutions, and particularly the clause in the constitution of 1868, to which reference has already been made. * * *
>
> Upon these issues there was judgment in favor of the bank, declaring the assessment null and void, and perpetuating the injunction."
>
> 167 U. S. at pages 379 and 380.

The Court further said:

> "Of course, if the judgments are the thing adjudged, and conclusively determine as between the parties that the exemption of the bank under its charter exists, to the extent determined by the judgments, the duty in that regard of discussing the charter itself will be eliminated, since the effect of the thing adjudged will settle the question."
>
> Id. page 387.

The Court noted the contention that:

> "* * * a judgment decreeing a tax of one year illegal can never be *res judicata* as to a tax for a

future year, although the right to tax for a future year is resisted upon the same facts and between the same parties and *upon identical legal grounds* held to be conclusive in a judgment previously rendered between them."

Id. page 388.

The Court also said:

"The second question then is this: Were the final judgments *which held that there was no power to levy the taxes* on the Citizens' Bank for the years 1886 and 1887 based upon *the identical claim of exemption* now asserted by the bank in order to defeat the taxes here in question?

And we ask the Court to note the following statement made by the Supreme Court, in deciding the question:

"In *Bank of United States v. Beverly,* 42 U. S. 1 How. 134-139, it was held that a construction of a will affecting the rights of the parties must govern in subsequent controversies between the same parties, *without reference to the different nature of the demands.* In *Tioga R. Co. v. Blosburg & C. R. Co.,* 87 U. S., 20 Wall. 137, and *Mason Lumber Co. v. Butchel,* 101 U. S. 638, *it was held* that when the proper construction of a contract was in controversy, *the construction adjudged by the court would bind the parties in all future disputes.*"

New Orleans v. Citizens' Bank, 167 U. S. 371, 42 L. ed. 202.

We believe that no criticism of these parts of this decision has been made, except upon the ground that a

decision relative to the validity of taxes for one tax year should not be held *res judicata* for later years, on the ground of public policy.

Notice the next to the last quotation above. The prior judgment invoked was rendered on the theory that there was "no power" to tax. So here the prior judgment was on the theory there was "no power" to impair these bonds.

The foregoing will make clearer the attack made upon the repetition of the grant of Federal judicial power here involved.

The appeal is from an interlocutory decree rendered by the United States District Court for the Southern District of California on February 21, 1939 (Tr. p. 235, Vol. 1), in a proceeding begun by respondent on June 17, 1938 (Tr. p. 8, Vol. 1), under *Section 83* of the Bankruptcy Act. This decree confirmed a plan of composition of the bonded indebtedness of said district.

The plan is that the bonded indebtedness of Merced Irrigation District amounting to $16,190,000.00 and interest accruing on and after July 1, 1933, shall be settled for 51.501% of principal, the money to be procured through a new bond issue to be taken by the Reconstruction Finance Corporation.

Appellants invoke a final decree of this Court rendered on April 12, 1937, on an appeal taken by them from a decree of the same United States District Court. The prior proceeding was brought by Merced Irrigation District under *Section 80* of the Bankruptcy Act against the appellants. The decree so

previously appealed from confirmed the same plan of composition of the same bonded indebtedness. Appellants contend that the rule of *res judicata* applies to *questions of law* as well as to questions of fact; that the grant of *Federal judicial power* under which the District Court acted in rendering its prior decree was the same as the grant of *Federal judicial power* under which the District Court acted in rendering the decree now appealed from. They contend that the said decree of this Court so invoked finally adjudged that such grant of power is unconstitutional, is beyond the power of Congress to make under the bankruptcy clause (Art. I, Sec. 8); that it adjudged that the exercise of *Federal judicial power* so granted would, because of the character of the indebtedness involved, constitute interference by the Federal Government with the sovereignty of the State of California; and secondly that the state was powerless to waive such interference or approve the remedy because of the contract clause (Art. I, Sec. 10) which prohibits the state from passing insolvency laws which affect existing contracts. As will appear, Section 80 accorded due process of law to the extent of providing a fair hearing. And it required a fair plan. There was nothing in the prior ruling which suggests that the fairness or moderation with which Federal judicial power might be exercised would save the Federal remedy. The remedy was condemned as inconsistent with state sovereignty and the state was held incapable of waiving the objection. The wisdom and moderation of the physician played no part in the decision. The point was that the physician, the United States District

Court, was unlicensed and that the lack of license could not be waived.

It is of course clear that the power of debt composition is nothing but bankruptcy power.

Continental Ill. N. B. & T. Co. v. C. R. I. & P. R. Co., 294 U. S. 648, 79 L. ed. 1111.

Long before the *Ashton* case, the elementary rule was that an enforced bankruptcy composition had to be fair and the Supreme Court in the *Ashton* case, obviously refused to save the grant of judicial power contained in Section 80 because the plan had to be 100 per cent fair.

And it was familiar law before the *Ashton* case was decided, that certain exertions of unusual authority by the Federal Government were permitted if the State consented. Of the operation of the Maternity Act it was said:

> "Probably it would be sufficient to point out that the powers of the state are not invaded, since the statute imposes no obligations but simply extends an option which the state is free to accept or refuse."
>
> *Massachusetts v. Mellon,* 262 U. S. 447, 67 L. ed 1078.

When a person obtains a judgment that a statutory grant of power—whether administrative or judicial—is void, he may not be endlessly required to re-try the issue by repeating the grant in new statutes.

We shall make it clear that under a constitutional government, the judiciary may test every grant of power that the legislative department may make and

that judgments as to such power are as final as are any judgments and are within the rule of *res judicata.*

We refer to the two sections:

Sec. 80, Bankruptcy Act, adopted *May 24, 1934,* Chap. 343, 48 Stat. at L. p. 798;

Sec. 83, Bankruptcy Act, adopted *Aug. 16, 1937,* Chap. 657, 50 Stat. at L. p. 653.

It is new kind of constitutional law to hint that judicial power of the Federal government is so mild that it may almost be said to be regulated by the States. Power within a Federal court is a part of the supreme sovereignty of the United States, and all means of executing the power is within the grant of the power. Said Chief Justice Marshall, in the following case:

> "One of the counsel for the defendants insists that Congress has no power over executions issued on judgments obtained by individuals; and that the authority of the states, on this subject, remains unaffected by the constitution. That the government of the Union cannot, by law, regulate the conduct of its officers in the service of executions on judgments rendered in the federal courts; but that the state legislatures retain complete authority over them.
>
> The court cannot accede to this novel construction. The constitution concludes its enumeration of granted powers, with a clause authorizing Congress to make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this constitution in the government of the United

> States, or in any department or officer thereof. The judicial department is invested with jurisdiction *in certain specified cases,* in all which it has power to render judgment.
>
> That a power to make laws for carrying into execution all the judgments which the judicial department has power to pronounce, is expressly conferred by this clause, seems to be one of those plain propositions which reasoning cannot render plainer. The terms of the clause neither require nor admit of elucidation. The court, therefore, will only say, that no doubt whatever is entertained on the power of Congress over the subject. The only inquiry is, how far has this power been exercised?''
>
> *Wayman v. Southard,* 10 Wheat. 1, 21, 22, 6 L. ed. 258.

It was of this high judicial power that the Supreme Court spoke in the *Ashton* case, which case was the basis of the prior decision of this Court.

Plainly the judicial department must determine whether the case is one of the *''specified cases'';* must determine whether a particular grant of judicial power may be made to a United States District Court.

We shall make it clear that in so far as grant of judicial power to, and restrictions on the judicial power of, the United States District Court are concerned the two sections are in the same terms. They in fact produced precisely the same judgment.

The judgment was not that Section 80 did not make provisions appropriate for a bankruptcy law or did

not accord due process of law, if there was power to adjudicate, or that a fair plan was prohibited. The judgment was that as the debts involved were public debts, the sovereignty of the State prohibited their settlement or discharge through a department of another sovereignty, the making of a decree by a Federal District Court which would fasten a new type of obligations upon the State agency in lieu of the old.

This Court's ruling on the said appeal is reported.

Bekins v. Merced Irr. Dist., 89 F. (2d) 1002.

On the going down of this Court's mandate, the United States District Court entered its decree on July 6, 1937, unconditionally dismissing the prior proceeding. That decree also is invoked in support of the plea.

This Court's ruling was based on the decision of the United States Supreme Court in the *Ashton* case decided on May 25, 1936.

Ashton v. Cameron Co. Water Improvement Dist., 298 U. S. 513, 80 L. ed. 1309.

That the *Ashton* case did, in unmistakable terms, decide the two issues mentioned, note carefully what is next quoted from the opinion in that case.

> "The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to *change, modify* or *impair* the obligation of their contracts. The statute before us expresses this design in plain terms. *It undertakes to extend the supposed power of the Federal Government incident to bankruptcy over any embarrassed district which may apply to the*

court. See Perry v. United States, 294 U. S. 330, 353, 79 L. ed. 912, 918, 55 S. Ct. 432, 95 A.L.R. 1335.

If obligations of States or their political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs; the will of Congress prevails over them; although inhibited, the right to tax might be less sinister. And really the sovereignty of the State, so often declared necessary to the federal system, does not exist. M'Culloch v. Maryland, 4 Wheat. 316, 430, 4 L. ed. 579, 607; Farmers & M. Sav. Bank v. Minnesota, 232 U.S. 516, 526, 58 L. ed. 706, 711, 34 S. Ct. 354.

The Constitution was careful to provide that 'No State shall pass any Law impairing the Obligation of Contracts.' *This she may not do under the form of a bankruptcy act or otherwise.* Sturges v. Crowninshield, 4 Wheat. 122, 191, 4 L. ed. 529, 547. *Nor do we think she can accomplish the same end by granting any permission necessary to enable Congress so to do."*

Ashton v. Cameron County W. I. District, 298 U. S. 513, 530, 80 L. ed. 1309, 1314.

Note the two-fold ruling. The case answers with precision the question involved in this case.

In the *Brush* case the Supreme Court itself later stated exactly what it had ruled in the *Ashton* case.

"We recently have held that the bankruptcy statutes could not be extended to municipalities or other political subdivisions of a state. Ashton v. Cameron County Water Improv. Dist., 298 U.S. 513, 80 L. ed. 1309, 56 S. Ct. 892, 31 Am. Bankr.

> Rep. (N.S.) 96. The respondent there was a water-improvement district organized by law to furnish water for irrigation and domestic uses. We said (pp. 527, 528) that respondent was a political subdivision of the state 'created for the local exercise of her sovereign powers, * * * Its fiscal affairs are those of the State, not subject to control or interference by the National Government, unless the right so to do is definitely accorded by the Federal Constitution.' In support of that holding, former decisions of this court with respect to the immunity of states and municipalities from federal taxation were relied upon as apposite. The question whether the district exercised governmental or merely corporate functions was distinctly in issue."
>
> *Brush v. Commissioner of Int. Rev.,* 300 U. S. 352, 81 L. ed. 691, 698.

The later case of *United States v. Bekins* upheld Section 83. It upheld the making of a decree of debt composition by the Federal Court, by the condemned agency of the *Ashton* case, and pronounced that such decree, vital to the whole proceeding, benefits and does not offend State sovereignty—particularly if the State consents. Secondly, it held that the contract clause does not stand in the way of such consent.

> *United States v. Bekins,* 304 U. S. 27, 82 L. ed. 1137.

The latter case in effect holds that the contract clause does not prohibit an invitation to the federal government to act. That is squarely in the face of the *Ashton* case.

This Court will be amazed to note *that as regards grant of power to the District Court and as regards restriction on power* (the part of the two laws with which we are concerned), the language of Section 83 is lifted from Section 80. We shall later do the comparing.

The Court will not therefore be at all amazed to note that the "fruit of the law", the judgment under each section, is the same.

All that is essential for these appellants to show is that a part of Section 80 determined to be invalid is an indispensable requirement of Section 83.

It is clear that the making of the decree by the condemned federal agency is the operative part, the effective part of Section 83—the offensive part under the *Ashton* case.

Note that the very consent which the Supreme Court upheld in the *Bekins* case, was in effect when the first bankruptcy proceeding was begun by Merced Irrigation District. The State act took effect as an emergency measure on *September 20, 1934.*

Cal. Stats. 1935, p. 5 (ex. sess. 1934 Chap. 4).

The first proceeding was begun on *April 19, 1935.*

Respondent contends that this prior determination was made under and relates to a different statute and further that the prior determination was rendered by a Court acting without jurisdiction and that the judgment of such a Court will not support the plea of *res judicata.* The trial Court sustained respondent's position.

In re Merced Irr. Dist., 25 Fed. Supp. 981, 987; Printed Opinion Tr. pp. 168, 186, Vol. I.

Neither contention is correct. Where a private litigant has obtained a judgment against his adversary that a part of a statute containing a grant of administrative or judicial power which affects the litigant's property rights is unconstitutional, the judgment confers a vested right although it may be subsequently determined that it is erroneous. Such judgment cannot be destroyed by incorporating the same grant of power in a later statute. The rule of *res judicata* is essential to judicial power.

Secondly the judgment relied on was a judgment of this Court rendered on proper appeal on the very question of jurisdiction. It was a judgment on the merits as to jurisdiction. That was ruled, in effect, in the late case of *Stoll v. Gottlieb* hereinbefore cited. And that case cites cases which are directly in point. It is common for supervisory Courts to determine the legal question of jurisdiction. In fact, as will be shown, a writ of prohibition will not issue if the complainant has a plain, speedy and adequate remedy by appeal. It is common to enjoin exercise of power contained in an invalid grant. And the legislature may not destroy the judgment by a new act.

As will appear, it may not be advisable to seek prohibition and refrain from appeal *because in some states both parties are not necessary parties in a prohibition proceeding.*

The evidence shows that in the former trial the appellants herein objected to jurisdiction both by way of motion to dismiss and in their answers; that they assigned the error on appeal and that, following

the decision in the *Ashton* case, they moved this Court to dispense with the printing of the record on appeal which had been filed in this Court and for a judgment of reversal with directions to dismiss on the ground that the *Ashton* case determined the question of jurisdiction and that they were entitled to a decree putting an end to the litigation; that the Court granted the motion and made the judgment applied for on April 12, 1937; that the District's application to the Supreme Court for certiorari was denied; that pursuant to this Court's mandate the trial Court entered its decree of dismissal on July 6, 1937.

At the opening of the references to the evidence in support of the plea, we have cited (see Appendix, page iv) various cases on what evidence is relevant to the plea. It is shown that this Court may take judicial notice of its own records that relate to the plea.

THE QUESTION INVOLVED.

The prior judgment determined the very question as to whether under the bankruptcy clause of the Constitution (Art. I, Sec. 8), Congress could grant to the United States District Court, a federal agency, the power to make a decree which would fasten on the irrigation district a new type of indebtedness and thereby discharge its existing bond obligations held by appellants; whether that would interfere with State sovereignty in view of the fact the indebtedness was public and whether the State had power to waive the interference and adopt the remedy under the contract clause. (Art. I, Sec. 10.)

We have referred to the recent case of *Stoll v. Gottlieb*. We are obviously dealing with a grant of great judicial power when concerned with a compo-

sition of bonded indebtedness amounting to $16,190,000.00.

> "In bankruptcy matters composition has a special meaning to-wit, a settlement or adjustment *which is enforced by the court* on all creditors after its acceptance by the required majority."
>
> *In re West Palm Beach,* 96 F. (2d) 85.

It is scarcely necessary to state that the contract of any political subdivision of a state may be enforced by appropriate remedies and that the doctrine of *res judicata* applies to judgments which affect bonds of such a political subdivision.

> *Cromwell v. County of Sac.,* 94 U. S. 351, 24 L. ed. 195.

While a bankruptcy proceeding is partly *in rem* nevertheless the bankrupt and the creditors are ordinary adversaries in a contest over a composition and a final order made in favor of a bankrupt debtor in such a proceeding is *res judicata* of any issue determined therein.

> *Myers v. International Trust Co.,* 263 U. S. 64, 68 L. ed. 165.

The same rule of course applies in favor of the contesting creditor.

Under Point III we discuss the rule that under a constitutional form of government the Courts construe the Constitution. In the following case the Supreme Court proceeded to construe the Constitution, the *limitation* therein on the power of Congress, the provision that "No tax or duty shall be laid on

any articles exported from any state" (Art. I, Sec. 9). A law had been passed compelling the stamping of an export bill of lading. The Supreme Court reviewed a conviction under the law. The Solicitor General argued: "This tax has been used for one hundred years", etc. (45 L. ed. 863.) But the law was invalidated on the ground that a correct construction of the constitution excluded the enactment. The Court spoke of its power to construe the Constitution and the care to be used. It said:

> "In the light of this rule the inquiry naturally is, Upon what principles and in what spirit *should the provisions of the Federal Constitution be construed?* There are in that instrument *grants of power, prohibitions, and* a general *reservation of ungranted powers.* That in the grant of powers there was no purpose to bind governmental action by the restrictive force of a code of criminal procedure has been again and again asserted. The words expressing the various grants in the Constitution are words of general import, and they are to be construed as such, and as granting to the full extent the powers named."
>
> *Fairbanks v. United States,* 181 U. S. 283, 287, 45 L. ed. 862, 864.

There are varying degrees of similarity between causes of action which are technically different. Technically, separate causes of action are not the same when they rest on the same contract; but in such a case the affiliation between the two suits is close. Here it is perfectly apparent that the relief claimed in this new proceeding must be rested upon the iden-

tical provision of the Constitution on which Section 80 was based. As regards terms of the grant of power the two sections are same. Natural indeed, therefore, it is to invoke the rule of *res judicata.*

We are dealing here with the construction of a power given to Congress; of a grant under that power. A letter of attorney may be construed by a judgment and the judgment be conclusive in a subsequent suit between the same parties. In the following case a "letter of attorney" given by one Lenton and wife, was, on a trial, construed for the purpose of determining whether it embraced the power to borrow money and whether it was in legal form. Judgment went against the principals on the question. In a second suit involving another cause of action, they raised the same *legal questions.* The Circuit Court of Appeals for the 8th Circuit, through Mr. Justice Sanborn, referred to the first suit and the issues determined thereby, and sustained the plea of *res judicata.*

The Court said:

> "Mr. and Mrs. Lenton answered this complaint that Finlay was not authorized, by this letter of attorney or otherwise, to borrow any money, or to make any note or mortgage on their behalf and that the letter of attorney had not been executed according to law and was not binding on them. The issues thus made were tried upon their merits, and a judgment was rendered by the County Court of Douglas County in favor of the insurance company for the full amount claimed in its complaint. At the trial which re-

sulted in that judgment the question whether or not the terms of the letter of attorney were sufficient to authorize Finlay to borrow money for appellants to execute notes therefor in their names and the question as to whether or not the certificate of acknowledgment was in accordance with the statutes were raised, litigated, argued and decided by the court against the appellants. The court of Douglas County held that the power vested by the terms of the letter of attorney was ample to enable Finlay to borrow money and to make the notes, and that the certificate of acknowledgment of the execution of the letter of attorney was in due and legal form. The judgment in that action conclusively estops the appellants from again litigating those questions." (Citing cases decided by the United States Supreme Court.) "* * * This suit is between the same parties who were involved in the action upon the coupon note due June 1, 1895, *but upon a cause of action different from that then in controversy* and every point and question which was actually and necessarily litigated and decided in that action is *res judicata* in this. The question as to whether or not the terms of the letter of attorney were broad enough to empower Finlay to borrow money for the appellants and to execute their notes to secure a new debt and the question as to whether or not the certificate of acknowledgment was in accordance with the law were raised, litigated and decided in that action and the appellants are conclusively estopped by the judgment therein from again presenting or litigating them here."

Lenton v. National Life Ins. Co. (8th Ct.), 104 F. 584, 587, 588.

The prior proceeding to which sought to impair the same bonds; and also in the same way, although the latter is not material to the point.

While technically bankruptcy alleged on one day is not bankruptcy alleged on a later day the two proceedings are in the same category. There was scarcely a hitch in the process of debt extinguishment here. It is not a case of a cause of action in ejectment and a later suit in equity to quiet title involving the construction of the same patent from the Federal government. There is even closer affinity here. The affinity is as close as between identical twins. They have the same origin, although one comes a little later.

Each section, Section 80 and Section 83, obviously stems from the same clause of the Constitution. It is a typical case of invoking a judgment settling a construction of an instrument which lies at the base of two suits. Note the following case.

The United States brought suit to quiet title to certain lands. Its claim of title depended on whether a certain map was a map of definite location under a railroad grant which definite location would remove such land from the operation of a junior grant to the Southern Pacific Railroad Company, the prior grant having been forfeited *subsequently* to the junior grant, so that the forfeiture would not feed the junior grant if the map amounted to a definite location. The United States prevailed on this issue. In a second suit, it was held that this judgment was *res judicata* on the character of this map. The second suit was

upon a different cause of action, an action to quiet title to other lands within the senior grant. The case was most elaborately and carefully argued. The court in applying the rule of *res judicata* said:

> "The general principle announced in numerous cases is that a *right, question* or *fact* distinctly put in issue and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; *and even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established,* so long as the judgment in the first suit remains unmodified. This general rule is demanded by the very object for which civil courts have been established, which is to secure the peace and repose of society by the settlement of matters capable of judicial determination."
>
> *Southern Pacific R. Co. v. United States,* 168 U. S. 1, pages 48, 49, 42 L. ed. 355, 377.

Federal Courts have authority to determine the validity of grants of power to a "judicial functionary". The trial court may pass on the question preliminarily.

> *Snead v. Central of Georgia Ry. Co.,* 151 F. 608.

But we are here concerned with a determination of this Court, a Court empowered to pass with finality on the constitutionality of grants of power to United States District Courts, to determine conclusively that a grant of judicial power is void.

We refer here to one of the cases declaring that the question determined by the prior judgment may be either one of law or of fact and referring to the importance of the rule of *res judicata.*

> "The general principal, applied in numerous decisions of this court, and definitely accepted in Southern Pacific R. Co. v. United States, 168 U.S. 1, 48, 49, 42 L. ed. 355, 376, 377, 18 Sup. Ct. Rep. 18, is, that *a question* of fact *or of law* distinctly *put in issue and directly determined* by a court of competent jurisdiction as a ground of recovery or defense in a suit or action between parties sui juris, *is conclusively settled by the final judgment* or decree therein, *so that it cannot be further litigated* in a subsequent suit between the same parties or their privies, *whether the second suit be for the same or a different cause of action.*"
>
> *Oklahoma v. Texas,* 256 U. S. 70, 85, 65 L. ed. 831, 834.

The rule is indispensable to a judicial system.

> "This doctrine of *res judicata* is not a mere matter of practice or procedure inherited from a more technical time than ours. It is a rule of fundamental and substantial justice, 'of public policy and of private peace,' which should be cordially regarded and enforced by the courts to the end that *rights once established by the final judgment* of a court of competent jurisdiction shall be recognized by those who are bound by it in every way, whenever the judgment is entitled to respect. Kessler v. Eldred, supra.
>
> *Hart Steel Co. v. Railroad Supply Co.,* 244 U. S. 294, 299, 61 L. ed. 1149, 1153.

We have this striking situation:

1. The agency which under Section 83 put into effect the plan was the same condemned federal agency—the United States District Court.

2. The terms of the new act are the same as those of the old in so far as grant of power to the said Court is concerned.

3. A new decree of the precise terms as the old has been made.

4. The State consented to the proceeding in each case.

THE TWO GRANTS OF JUDICIAL POWER ARE IN THE SAME TERMS.

We next quote from and comment upon the language of the two sections and then refer to the findings and decrees in the two cases:

First as to restrictions on powers.

Subdivision (c) of Section 80 prohibited the Court from interfering with governmental powers of the State, the language being——

> "* * * but (11) shall not, by any order or decree, in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the taxing district, or (b) any of the property or revenues of the taxing district necessary in the opinion of the judge for essential governmental purposes, or (c) any income-producing property, unless the plan of readjustment so provides."

The end of subdivision (c) of Section 83 contains the same prohibition in the following language:

> "* * * but shall not, by any order or decree, in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the petitioner; or (b) any of the property or revenues of the petitioner necessary for essential governmental purposes; or (c) any income-producing property, unless the plan of composition so provides."

So much for the restrictions which each section placed upon the power of the Court. We may well contend that these specific restrictions limited the grants of power to the Court which were found in Section 80. These are provisos and have the usual purpose of provisos. But we do not need to invoke this rather obvious rule.

Section 83 contains the same grant of power to the Court, the Federal agency, which is found in Section 80.

We quote the grant of power to the District Court contained in Section 80:

> "(e) After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair, equitable, and for the best interests of the creditors, and does not discriminate unfairly in favor of any class of creditors; (2) complies with the provisions of subdivision (b) of this chapter; (3) has been accepted and approved as required by the provisions of subdivision (d) of this chapter; (4) all amounts to be paid by the taxing district for

services or expenses incident to the readjustment have been fully disclosed and are reasonable; (5) the offer of the plan and its acceptance are in good faith; and (6) the taxing district is authorized by law, upon confirmation of the plan, to take all action necessary to carry out the plan. *Before a plan is confirmed, changes and modifications may be made therein,* with the approval of the judge after hearing upon notice to creditors, subject to the right of any creditor who shall previously have accepted the plan to withdraw his acceptance, within a period to be fixed by the judge and after such notice as the judge may direct, if, in the opinion of the judge, the change or modification will be materially adverse to the interest of such creditor, and if any creditor having such right of withdrawal shall not withdraw within such period, he shall be deemed to have accepted the plan as changed or modified: *Provided, however,* that the plan as changed or modified shall comply with all the provisions of this subdivision."

We next quote the grant of power as contained in Subdivision (e) of Section 83:

"(e) At the conclusion of the hearing, the judge shall make written findings of fact and his conclusions of law thereon, and shall enter an interlocutory decree confirming the plan if satisfied that (1) it is fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors; (2) complies with the provisions of this chapter; (3) has been accepted and approved as required by the *provisions* of subdivision (d) of

this section; (4) all amounts to be paid by the petitioner for services or expenses incident to the composition have been fully disclosed and are reasonable; (5) the offer of the plan and its acceptance are in good faith; and (6) the petitioner is authorized by law to take all action necessary to be taken by it to carry out the plan. If not so satisfied, the judge shall enter an order dismissing the proceeding."

Note the "1", the "2", the "3", the "4", the "5" and the "6".

Next note that, to be sure the plan will be fair, Section 83, provides also for modification. We quote from Section 83:

"*Before a plan is confirmed, changes and modifications may be made therein,* with the approval of the judge after hearing upon such notice to creditors as the judge may direct, subject to the right of any creditor who shall previously have accepted the plan to withdraw his acceptance, within a period to be fixed by the judge and after such notice as the judge may direct, if, in the opinion of the judge, the change or modification will be materially adverse to the interest of such creditor, and if any creditor having such right of withdrawal shall not withdraw within such period, he shall be deemed to have accepted the plan as changed or modified: *Provided, however,* That the plan as changed or modified shall comply with all the provisions of this chapter and shall have been accepted in writing by the petitioner."

Bankruptcy Act, Sec. 83.

Neither Einstein or a school boy could say that the use of the Federal Court decree condemned in the *Ashton* case is not indispensable to Section 83, that it is not the thing that spells the doom of these respondents' bonds heretofore held immune from the authority sought to be exercised.

Is it amazing that the same judgment was borne under Section 83 as was borne under Section 80?

It is true that Section 80 refers to the first decree as a final decree and it states in Subdivision (d):

> "* * * the final decree shall discharge the taxing district of those debts and liabilities dealt with in the Plan except as provided in the Plan"; etc.

In Section 83, the decree on the merits is called an interlocutory decree and that decree is the one that is made appealable, but when the Court determines that the Plan has been carried out, a decree called a "final decree" is entered and it is the decree which discharges the district from its debts except as dealt with in the Plan. Subdivision (f) of the new section reads:

> "And thereupon the court shall enter a final decree determining that the petitioner has made available for the creditors affected by the plan the consideration provided for therein and is discharged from all debts and liabilities dealt with in the plan except as provided therein," etc.

If the rights of a bondholder are annihilated he is not concerned whether the decree that does that is called an interlocutory decree or a final decree.

In the following case the Court very properly declared the *Bekins* case overruled the substance of the *Ashton* case.

Supreme Forest Woodmen Circle v. City of Belton, 100 F. (2d) 655 at p. 657.

Of necessity that is so because each section expressed the same judicial power in practically the same terms and Section 83 lets us go as far but no further than Section 80, if the provisos quoted mean anything.

It is not necessary to sustaining here the plea of *res judicata* that this Court shall determine that Section 83 is precisely the same as Section 80. We are concerned with the substance of the determination in the *Ashton* case and that determination was that if the putting into effect of new indebtedness of an irrigation district was in any way made dependent upon the trial and investigation and determination of a United States District Court the result was an unauthorized interference with the sovereignty of the State of California.

THE TWO DECREES ARE THE SAME.

Findings made by a Court even when not required are of great importance in determining what issues were disposed of.

Last Chance Mining Co. v. Taylor Mining Co., 157 U. S. 683, 39 L. ed. 859.

Here the findings do at least indicate exercise of the same judicial power.

The United States District Court was required to find in this proceeding exactly what it was required to find and did find in the prior proceeding. Section 83(e) requires that:

1. The Court shall find that the plan is fair, equitable and for the best interests of the creditors and does not discriminate;

2. That it complies with the provisions of this chapter, the reference being to new Chapter X;

3. That it has been accepted as required by the provisions of subdivision (d), the reference being to Section 83;

4. That all amounts to be paid by the petitioner for services and expenses have been disclosed and are reasonable;

5. That the offer of the plan and its acceptance are in good faith; and

6. That petitioner is authorized to take all action necessary to carry out the plan and then the section states:

> "If not so satisfied, the judge shall enter an order dismissing the proceeding."

Now note the determination of the Court in the prior proceeding as incorporated in the final decree rendered therein. We quote from pages 280 and 281 of the final decree contained in the printed transcript of the prior appeal, Respondents' Exhibit "OO":

> "2. Said Plan of Readjustment is fair, equitable and for the best interests of the creditors of petitioner, and does not discriminate unfairly in favor of any class of creditors.

3. Said Plan of Readjustment complies with the provisions of subdivision (b) of Section 80 of Chapter IX of said National Bankruptcy Act.

4. Said Plan of Readjustment has been accepted and approved as required by the provisions of subdivision (d) of Section 80 of Chapter IX of said National Bankruptcy Act.

5. All amounts to be paid by petitioner for services or expenses incident to said Plan of Readjustment have been fully disclosed and are reasonable.

6. The offer of said Plan of Readjustment and its acceptance are in good faith.

7. Petitioner is authorized by law to take all action necessary to carry out said Plan of Readjustment."

Respondents' Exhibit "OO", pp. 208 and 281.

These same determinations were incorporated in Findings XIII, XIV and XV which were made in the prior proceeding.

See printed Transcript, Respondents' Exhibit "OO", pp. 244 and 245.

We next take the single paragraph from the Court's findings *in this case* made under Section 83 and we split the same into paragraphs numbered to correspond with the numbering in the prior decree and we have the following:

2. "That the plan of composition as offered by the petitioner herein is fair, equitable and for the best interests of its creditors and does not discriminate unfairly in favor of or against any creditor or creditors or class of creditors;

3. "that the plan of composition complies with the provisions of Section 83, Chapter IX of the Bankruptcy Act of the United States, and all of the provisions of Public No. 302 enacted by the Seventy-fifth Congress, approved August 16, 1937.

4. "That before the filing of the petition herein, said plan of composition was accepted and approved in writing by or on behalf of creditors of petitioner owning and holding more than ninety per cent (90%) of the aggregate amount of claims of all classes affected by such plan, excluding, however, claims owned, held or controlled by petitioner;

5. "that all amounts to be paid by petitioner for services or expenses incident to the composition have been fully disclosed and are reasonable and

6. "that the offer of the plan and its acceptance are in good faith;

7. "and petitioner is authorized by law upon confirmation of the plan to take all action necessary to carry out the terms thereof."

(Tr. p. 214, Vol. 1.)

Finding 6 made by the Court in this proceeding is to the effect that all the allegations of the petition are true.

(Tr. p. 215, Vol. 1.)

The said petition contains precisely what is set forth in the seven detailed findings which we have set forth.

(See par. VI of the Petition, Tr. p. 20, Vol. 1.)

The conclusions of law in this proceeding recite that the petitioner is entitled to an interlocutory decree

which conforms to Section 83. This interlocutory decree also proceeds to find that all the allegations of the petition are true.

(See par. 6 of Interlocutory Decree, Tr. p. 226, Vol. 1.)

Three times then, the Court determined what was determined in the prior proceeding.

The interlocutory decree further sets forth the mechanics of the settlement, *after the doom of the bondholders has been spelled.* It prescribes exactly what the procedure will be for the paying of the cash for the bonds and coupons.

(Tr. pp. 232 to 235, Vol. 1.)

No one ever dreamed of assailing Section 80 because of any inadequacy in the method of settling, once the Court made the decree that the bonds should be settled at the rate of 51.501% on the dollar of principal. In fact the final decree in the prior case set out an orderly and careful procedure for the turning in of the bonds and the receipt of the cash therefor *and the issuance of the new bonds to the R. F. C.*

(Respondents' Exhibit OO, pp. 278-282.)

AS TO INTERFERENCE.

It is respectfully pointed out that in its general character and as regards grant of power to and limitation on power of the federal agency, the United States District Court, Section 83 was not a different law. It was a law in the same terms emanating from the same Constitution of limited or granted power.

It produced the same decree, following a trial at which was introduced all the evidence used in the first trial. It used the same condemned agency to destroy the same bonds.

True, Section 83 calls the decree an interlocutory decree and says that before the "discharge" occurs, you shall have the "final" decree, whereas Section 80 called for a single funeral ceremony. But a judgment which actually determines a case is, in substance, a final judgment although it requires further steps to carry it out.

Guaranty Trust etc. Bank v. Los Angeles, 186 Cal. at pages 116 and 117.

All decrees of the Circuit Courts of Appeals and of United States District Courts which were entered pursuant to the ruling in the *Ashton* case were based upon the broad proposition that the use of a decree of a United States District Court to fasten into the debt structure of an irrigation district a new type of indebtedness for the purpose of discharging old indebtedness of such district constituted an unauthorized interference with the sovereignty of the state; that the power was not within the bankruptcy clause of Article I, Section 8, of the Constitution, because of the nature of the indebtedness; and the state could not waive the point by adopting the federal remedy of bankruptcy because of the contract clause, Article I, Section 10. The *Bekins* case says the interference is innocuous.

But we urge that the power to determine a plan affecting $16,190,000 of public indebtedness dependent

for payment on a taxing district comprising the most valuable part of large county and containing various incorporated cities and towns is no mean power. An elaborate trial was had. Stay of all proceedings against the district was enjoined by the Federal Court. The plan in each case contemplated that. The second plan was but a renewal of the first plan. *By this and the prior proceeding* the district has withheld payment of a 5 cent piece on any of its bonds for over six years and it may take another year to end this cause. That has a vital bearing on public credit. It was not mere fancy that the provision for the making of a federal decree might have a material effect on the fiscal affairs of Merced Irrigation District. The decree lops off over $8,000,000.00 in debts and fastens a new type of bonds upon the district which are to be received by the Reconstruction Finance Corporation.

The very threat of the powers here involved will for years to come cast doubt on the security resting on the obligation to pay taxes. Section 80 was and Section 83 is an invitation to default. It is not a nice thing to urge that means of escape from an obligation may encourage default, but we contend that securities of the highest known quality have been degraded by these laws.

It is true the district initiates the proceeding, but on doing so it is subject to a judgment of a branch of the federal government, the judiciary. The federal government designed the procedure. The Court says to the district and the dissenting bondholders: The

plan shall go into effect if and only if the Court decides upon the evidence that it is fair and shall be put into effect. The fact that the decree is called one of confirmation makes it none the less the act which does fix the new debts into the debt structure of the district. The fact that it does and that we have a federal court decree is the thing that requires surrender of the old bonds.

We have a mixing of jurisdiction which for over a hundred years was not deemed permissible. The final ruling of the Supreme Court is that the boundaries of the grant of bankruptcy power remain undefined.

Wright v. Union Central Life Ins. Co., 304 U. S. 502, 513, 82 L. ed. 1490, 1499.

Many cases were cited by the learned Supreme Court but not the *Ashton* case.

The Argument already made in part may be divided into the points next stated. Among the most important, in view of the District Court's opinion, is Point IV that the judgment relied on is a judgment of this Court and is not a judgment of a court without jurisdiction.

POINTS ARGUED.

I. THE PRIOR JUDGMENT PASSED ON AND DETERMINED THE QUESTION HERE INVOLVED—THAT UNDER THE BANKRUPTCY CLAUSE (ART. I, SEC. 8) THE DISTRICT COURT COULD NOT BE GRANTED THE AUTHORITY PROVIDED IN SECTION 83 AND THAT THE STATE COULD NOT ACCEPT

THE FUNCTIONING OF SUCH AGENCY UNDER THE PROHIBITION OF THE CONTRACT CLAUSE (ART. I, SEC. 10).

(a) SECTION 83 EMPLOYS THE SAME CONDEMNED AGENCY, THE UNITED STATES DISTRICT COURT.

(b) THE GRANT OF POWER TO THAT COURT IS IN THE SAME TERMS.

(c) THE DECREE RENDERED IS IN THE SAME TERMS.

(d) THE CONSENT IS THE SAME CONSENT.

(Argued in the Statement.)

II. IT IS OBVIOUS THAT SECTION 80 WAS NOT INVALIDATED FOR FAILURE TO ACCORD DUE PROCESS OF LAW.

(a) IT REQUIRED PLEADINGS, PROCESS, A FAIR HEARING, EVERY ORDINARY ESSENTIAL TO THE EXERCISE OF JUDICIAL POWER.

(b) IT REQUIRED A FAIR PLAN.

(c) IT WAS PATTERNED ON SECTION 77, THE RAILROAD REORGANIZATION ACT, WHICH HAD BEEN UPHELD BEFORE THE ASHTON CASE WAS DECIDED.

(d) SECTION 77 (b) FOLLOWED THE SAME PATTERN AND THAT ACT HAS BEEN CONSTANTLY APPLIED.

Page 41 hereof.

III. UNDER A CONSTITUTIONAL FORM OF GOVERNMENT, ALL LAWS, ALL GRANTS OF POWER ARE SUBJECT TO JUDICIAL POWER AND MUST STAND THE TEST OF THE CONSTITUTION, THE JUDICIARY APPLIES ITS TEST, AND A JUDGMENT ON CONSTITUTIONALITY IS RES JUDICATA.

Page 42 hereof.

IV. An appellate court is empowered to pass finally on the question of jurisdiction of a trial court.

The judgment here involved is in effect a judgment of this court determining finally the validity of the attempted grant of judicial power to the United States District Court.

The rule applies to determination of questions of jurisdiction which are purely questions of law.

Page 45 hereof.

V. The rule of res judicata applies to all questions of law, to the constitutionality of granted power, whether administrative or judicial, to validity of laws, ordinances and contracts.

Injunction is a common remedy against invasion of private rights under unconstitutional authority.

Page 50 hereof.

VI. Rights vest under a determination made by a final decree and the Legislature cannot destroy such rights.

Page 59 hereof.

VII. The doctrine of res judicata is essential to an orderly judicial system.

Page 60 hereof.

POINT I.

(This point has been argued.)

POINT II.

IT IS OBVIOUS THAT SECTION 80 WAS NOT INVALIDATED FOR FAILURE TO ACCORD DUE PROCESS OF LAW.

(a) IT REQUIRED PLEADINGS, PROCESS, A FAIR HEARING, EVERY ORDINARY ESSENTIAL TO THE EXERCISE OF JUDICIAL POWER.

(b) IT REQUIRED A FAIR PLAN.

(c) IT WAS PATTERNED ON SECTION 77, THE RAILROAD REORGANIZATION ACT, WHICH HAD BEEN UPHELD BEFORE THE ASHTON CASE WAS DECIDED.

(d) SECTION 77 (b), FOLLOWED THE SAME PATTERN AND THAT ACT HAS BEEN CONSTANTLY APPLIED.

It is obvious that Section 80 could not have been invalidated because it failed to require a determination by the Court that the plan to be enforced was fair. It is equally obvious that the section could not have been invalidated for failure to accord due process of law or a fair hearing to the dissenting bondholders. In the first place it is clear that Section 77 of the Bankruptcy Act relating to the reorganization of railroads engaged in interstate commerce was the pattern which was followed in the adopting of Section 80 on *May 24, 1934.* Section 77 was adopted on *March 3, 1933.*

Chap. 204, 47 Stats. at L. 1467.

In adopting Section 77B relating to the reorganization of corporations generally, Congress likewise followed the pattern of said Section 77. Section 77B was adopted on *June 7, 1934.*

Chap. 424, 48 Stats. at L. p. 911.

Each one of these sections required that the court should determine that the plan of reorganization should be fair and that all creditors should be ac-

corded a full and a fair hearing. In his dissenting opinion in the *Ashton* case, Justice Cardozo took pains to point out that Section 80 was skillfully drawn. *Before Section 80 was invalidated, Section 77 had been fully sustained.*

Continental Illinois Nat. Bank & T. Co. vs. Chicago R. I. & P. R. Co., 294 U. S. 648, 79 L. ed. 1110 (decided April 1, 1935).

POINT III.

UNDER A CONSTITUTIONAL FORM OF GOVERNMENT, ALL LAWS, ALL GRANTS OF POWER ARE SUBJECT TO JUDICIAL POWER AND MUST STAND THE TEST OF THE CONSTITUTION, THE JUDICIARY APPLIES ITS TEST, AND A JUDGMENT ON CONSTITUTIONALITY IS RES JUDICATA.

The Supreme Court said:

> "The Constitution, by its own terms, is the supreme law of the land, emananting from the people, the repository of ultimate sovereignty under our form of government. A congressional statute, on the other hand, is the act of an agency of this sovereign authority, and, if it conflict with the Constitution, must fall; for that which is not supreme must yield to that which is. To hold it invalid (if it be invalid) is a plain exercise of the judicial power,—that power vested in courts to enable them to administer justice according to law."

Adkins v. Children's Hospital, 261 U. S. 525, 544, 67 L. ed. 785, 791.

Parliament on the other hand is supreme.

1 Blackstone Comm. p. 161.

While the federal Constitution is a most solemn grant or charter of powers, authority exercised under laws made pursuant to it is constantly tested.

In last analysis, adjudging that particular authority is outside that compact is no more than judging that an agent acting under a power of attorney or a trustee acting under a trust was not given authority to dispose of property. It was at once established that the federal courts must pass on every statute or grant of power enacted by Congress.

> "If an act of the legislature, repugnant to the Constitution, is void, does it, notwithstanding its invalidity, bind the courts, and oblige them to give it effect? Or, in other words, though it be not law, does it constitute a rule as operative as if it were a law? This would be to overthrow in fact what was established in theory; and would seem, at first view, an absurdity too gross to be insisted on. It shall, however, receive a more attentive consideration."
>
> *Marbury v. Madison,* 1 Cranch 137, 177, 2 L. ed. 60, 73.

> "It is now settled doctrine 'that individuals who, as officers of the state, are clothed with some duty in regard to the enforcement of the laws of the state, and who threaten and are about to commence proceedings, either of a civil or criminal nature, to enforce against parties affected *an unconstitutional act,* violating the Federal Constitution, may be enjoined by a Federal court of equity from such action.' "
>
> *Cavanaugh v. Looney,* 248 U. S. 453, 456, 63 L. ed. 348, 358.

The text Freeman further states:

> "An adjudication as to the *constitutionality* of a law *upon which a claim* or *cause of action is based* is *res judicata* so far as that claim or cause of action is concerned even though in another case in a higher court the law is adjudged constitutional."
>
> Freeman on Judgments (5th ed.), Sec. 711, p. 1499.

Cooley, Const. Lim., p. 5, states:

> "In American constitutional law, the word constitution is used in a restricted sense, as implying *the written instrument agreed upon by the people of the Union,* or any one of the States as the absolute rule of action and decision for all departments and officers of the government, in respect to all points covered by it, which must control until it shall be changed by the authority which established it."

Construction of contracts or city charters is constantly before the courts.

There is no reason why the proper court may not construe the "written instrument," the Constitution, as containing no clause that says Congress may empower a United States District Court to fasten into the debt structure of a California irrigation district a new type of debts and thereby discharge its existing indebtedness; that that would constitute material and unauthorized interference with state sovereignty.

POINT IV.

AN APPELLATE COURT IS EMPOWERED TO PASS FINALLY ON THE QUESTION OF JURISDICTION OF A TRIAL COURT.

THE JUDGMENT HERE INVOLVED IS IN EFFECT A JUDGMENT OF THIS COURT DETERMINING FINALLY THE INVALIDITY OF THE ATTEMPTED GRANT OF JUDICIAL POWER TO THE UNITED STATES DISTRICT COURT.

THE RULE APPLIES TO DETERMINATION OF QUESTIONS OF JURISDICTION WHICH ARE PURELY QUESTIONS OF LAW.

A judgment entered pursuant to a mandate of an Appellate Court *is, in substance, the judgment of the Appellate Court* and it is non-appealable and unchangeable.

> "In *Stewart v. Salamon,* 97 U.S. 361 (Bk. 24 L. ed. 1044), this rule was promulgated: 'An appeal will not be entertained by this court from a decree entered in a circuit court or other inferior court in exact accordance with our mandate upon a previous appeal. *Such a decree when entered is in effect our decree,* and the appeal would be from ourselves to ourselves. If such an appeal is taken, however, we will, upon the application of the appellee, examine the decree entered and, if it conforms to the mandate, dismiss the case with costs. If it does not, the case will be remanded, with appropriate directions for the correction of the error.' "
>
> *MacKall v. Richards,* 116 U. S. 45, 29 L. ed. 558.

The following case states the point and summarizes the authorities:

> *Peavy-Byrnes Lumber Co. v. Commissioner,* 86 Fed. (2d) 234, 235.

A judgment of affirmance or a directed judgment is absolutely unalterable.

Ex parte Washington & Georgetown Rr. Co., 140 U. S. 91, 35 L. ed. 339.

In its relation to the trial court, the judgment of this court was not in principle different from a decree enjoining the exercise of unconstitutional administrative power.

The Supreme Court of any state conclusively determines the jurisdiction of trial courts of the state. Such a judgment is in no sense a nullity. The language of Chief Justice Marshall in the opinion in the following case is directly in point:

> "It is not to be admitted that the court whose judgment has been reversed or affirmed, can rejudge that reversal or affirmance; but it must be conceded that the court of *dernier* resort in every State decides upon its own jurisdiction, and upon the jurisdiction of all the inferior courts to which its appellate power extends. Assuming these propositions as judicial axioms, we will inquire whether the judgment of the Court of Errors for the State of New York is in violation of the mandate of this court."
>
> *Davis, Consul, etc. v. Packard,* 8 Peters 308, 323, 8 L. ed. 957, 961.

The full faith and credit provision applies to judgments of the highest court of a state as to the power of trial courts within the state. On this point it was remarked with respect to a judgment of the Supreme Court of Pennsylvania:

> * * * and in rendering its judgment of affirmance the court necessarily determined its own jurisdiction."
>
> *Van Matre v. Sankey,* 148 Ill. 536, 36 N. E. 628, 23 L. R. A. at p. 671.

Specifically the Supreme Court recognizes that the judgment of an appellate court may become *res judicata* on the question of power or jurisdiction vested in a trial court.

In the following case the Supreme Court of the United States reversed a Circuit Court of Appeals judgment, the latter court having declined to hold that the Supreme Court of a State had, on appeal from a lower state court, power finally to determine jurisdiction in favor of such lower state court. The state court judgment had been pleaded as *res judicata.* The claim was that the state courts had in rendering the judgments invoked exercised power legislative in character.

> *Forsyth v. City of Hammond,* 166 U. S. 506, 41 L. ed. 1095.

As will be shown, it is quite common to obtain judgments against the validity of administrative power or as to the validity of laws affecting property rights or personal rights. It is equally clear that judgments may be obtained determining that judicial power is invalid or valid. The issue may be purely one of law arising on the face of the record. If the remedy is not plain, speedy or adequate, resort may be had to prohibition or mandamus in order to test

the validity of a trial court's power. If the special proceeding does not lie, the question of jurisdiction is tried out on appeal, but the judgment that is obtained is *res judicata as between the parties in any cause involving the same issue.* This is clearly shown by the Supreme Court case already cited.

Stoll v. Gottlieb, 305 U. S. 165, 83 L. ed. (Adv. Sheets) p. 116.

The case clearly shows that the Supreme Court has now established it as the rule that a trial court may, generally speaking, determine its own jurisdiction, in case the issue of jurisdiction is contested, that it may do this even though jurisdiction or want of jurisdiction appears on the face of the record, at least if there is such degree of uncertainty in the statute purporting to confer jurisdiction as to actually call for judicial construction. The case shows that the trial court's judgment in the event there is reasonable ground for dispute becomes binding and may be invoked in support of the plea of *res judicata.*

Judge McCormick's opinion is based on general rules which are not applicable. The following text states:

> "There can be no doubt that the dismissal of an action or denial of relief for want of jurisdiction is not a judgment on the merits and cannot prevent the plaintiff from subsequently prosecuting the action in any court authorized to determine it."
>
> Freeman on Judgments (5th ed.), Sec. 733, p. 1546.

But says the author:

> "Questions of *jurisdiction* may become *res judicata* the same as any other matters of *law or fact where they are properly in issue or are necessarily involved and determined.*"
>
> Id. Sec. 710, p. 1498.

The author refers to the fact that a final writ of prohibition does adjudicate the question of power.

But it is certainly safer to test out the question of jurisdiction and power of a trial court by an appeal than it is by an application for a writ of prohibition because in some jurisdictions the opposite party is not a necessary party to an application for a writ of prohibition. *In some cases the statute makes him a necessary party. But the rule differs in different jurisdictions.*

50 Corpus Juris, page 699.

It is not arguable that if a party appeals on the question of jurisdiction he and his adversary are not parties to the final judgment.

Prohibition will not lie, nor will certiorari lie where the question of jurisdiction can be conveniently determined by an appeal. It makes no difference that the judgment will be void in an "extreme sense."

White v. Superior Court, 110 Cal. 54.

The general rule is that if a case is dismissed for want of jurisdiction, the judgment is not a bar or an estoppel on the merits.

Smith v. McNeal, 109 U. S. 426; 27 L. ed. 986.

The general rule is thus stated:

> "But where the question of jurisdiction is one of law, a court cannot by an erroneous decision acquire jurisdiction which it has not or divest itself of jurisdiction which it has."
>
> 15 Corpus Juris p. 853.

The general rule is that assumption by a trial Court of power to proceed in a cause when the power does not exist does not create jurisdiction.

> *Brougham v. Oceanic Steamship Co.,* 205 Fed. 857, 126 C.C.A. 325.

But the trial Court may, of course, determine all questions of fact not required to be matter of record and which are essential to jurisdiction.

> *Toy Toy v. Hopkins,* 212 U. S. 542, 53 L. ed. 645.

POINT V.

THE RULE OF RES JUDICATA APPLIES TO ALL QUESTIONS OF LAW, TO THE CONSTITUTIONALITY OF GRANTED POWER WHETHER ADMINISTRATIVE OR JUDICIAL, TO VALIDITY OF LAWS, ORDINANCES AND CONTRACTS.

INJUNCTION IS A COMMON REMEDY AGAINST INVASION OF PRIVATE RIGHTS UNDER UNCONSTITUTIONAL AUTHORITY.

A constitution is a compact between the states. It is a charter of authority. It may be finally construed in litigation between parties, like any other contract. The question is one of law.

We mention another tax case. The same charter granted by the State of South Carolina lay at the base

of the two decisions involved and the question in this tax case also was, Was the prior decision placed on the ground of exemption generally? It was so ruled. The facts were: *In 1868 South Carolina passed a law* for the assessment of the property of a successor corporation. One Pegues, a stockholder, brought suit to enjoin that corporation from paying the taxes assessed, claiming that the taxing was not permissible under the charter of the ~~latter~~ predecessor corporation. The Attorney General of the State appeared for the tax officials and their answer denied the existence of the contract exemption. The Court perpetually enjoined the collection of the taxes on the ground of the charter exemption and this judgment was affirmed (*Humphrey v. Pegues,* 16 Wall. 244, 21 L. ed. 326). *Later on in the year 1900 South Carolina passed a new taxing statute* providing again for taxing the property of the corporation. This second law was invalidated under the rule of *res judicata,* the Supreme Court holding that the question of right to tax at all was embraced in the first judgment, that the first case involved a construction of the company's charter. It said:

> "That the issue in the case was the existence of a charter *exemption* from taxation in favor of the Cheraw & Darlington Railroad Company and the consequent *want of power* of the state to tax the *property of the railroad during the continuance of the exemption is obvious.* And that the decree rendered in the case established the exemption embraced in the issue is also obvious. This being true it unquestionably follows that the

> decree established as to the parties and their privies *the very question in issue* in this proceeding."
>
> *Gunter v. Atlantic Coast Line R. Co.,* 200 U. S. 273 at 290, 50 L. ed. 486, 487.

The Supreme Court upheld the plea. It cited the case which has been cited many times on the point that where a question upon which a right depends is determined in a prior suit the determination is binding in a second suit.

> *New Orleans v. Citizens Bank,* 167 U. S. 371, 42 L. ed. 202.

Section 83 might have varied the procedure of Section 80 and changed names of different steps in the proceeding. It might have said that if ten percent or no percent of the creditors consented to a plan the Court could enforce it. But the truth is that notwithstanding any changes in words or lettering of sentences, the trial eventuates in that which offends the sovereignty of the state in the same manner that the decree of Section 80 offended, as determined in the *Ashton* case. It was not the form of trial, the form of the petition, the form of the consents or the name of the decree that counted. It was that an effectuating federal decree was not permissible under our plan of separate sovereignties.

And if a court enjoins the enforcement of a law because it is unconstitutional or because the part of it which is assailed is unconstitutional it is trifling with judical power to say the judgment may be de-

stroyed by the device of repeating the legislation in a new act. The legislature cannot destroy adjudications of right in that way.

A sales stamp company began business in West Virginia. The State Tax Commissioner notified them to pay a license tax of $500.00. Suit was started at the suggestion of the Commissioner to enjoin the tax. The complaint filed in the state court charged the tax *law* was *unconstitutional.* The Court sustained a demurrer. On appeal *the Supreme Court of the State affirmed the decree.* Later the stamp company went into the federal court charging again the act was unconstitutional, but the bill showed the prior proceeding. A demurrer was sustained by three federal judges on the ground of *res judicata.*

Sperry & Hutchinson Co. v. Blue, 202 Fed. 82.

> "A judgment upholding the *validity* of an ordinance regulating the height of billboards is *res judicata* as between the same parties in a subsequent suit to restrain its enforcement *with respect to other structures* of the same character. * * * And a judgment establishing a claim dependent upon a particular statute *necessarily* adjudicates the validity and constitutionality of that law."
>
> Freeman on Judgments (5th ed.), Sec. 709, pp. 1496-7.

Neither national or state agencies are immune from injunction when attempting to act under unconstitutional or invalid authority.

Injunction lies against enforcement of regulations relating to the oil industry which have been promulgated under a grant of authority to the President determined to be outside the Constitution.

Panama Refining Co. v. Ryan, 293 U. S. 388, 79 L. ed. 446.

Is it not clear that the oil company which obtained the adjudication of invalidity of the grant of power could not be endlessly harassed by repeating the same grant in a new act? Obviously the only difficulty would be that appearing in the tax exemption cases—whether the government was a party to the prior proceeding.

Obviously the government is a party to a criminal proceeding and it is held that the plea of *res judicata* applies in such proceedings as well as the plea of once in jeopardy. Error in the prior ruling on a special plea in bar becomes immaterial once the ruling is final. It was purely a question of law.

United States v. Rabinowich, 238 U. S. 78, 59 L. ed. 1211.

Yosemite Park & C. Co. had authority from the federal government to sell liquor in Yosemite Park. The State had, subject to certain qualifications, granted to the federal government jurisdiction over the park area. The State endeavored to compel the company to take out a liquor license which was merely *regulatory* and not for revenue. The company brought suit against Collins, the enforcement officer, to enjoin the enforcement of the State Act. It was ruled that while the State could levy excise taxes

on the liquor business within the park, regulatory licensing was not permitted *and an injunction was granted to the company.*

Collins v. Yosemite Park & C. Co., 304 U. S. 518, 82 L. ed. 1502, 82 L. ed. (Adv. Sheets) p. 1009.

That case involved a species of "treaty" between sovereigns, the state and the federal government. *It involved a grant of authority, such as the Constitution.*

Is it conceivable that if the State's officers later sought to enforce the same invalidated law or any other license law the injunction judgment which construed the limits of the "treaty" would not have been binding?

We have mentioned the case of *United States v. Moser.* In that case the court specifically held the rule applies to questions of law. And the causes of action were different. One Moser obtained a judgment in the Court of Claims against the United States in a suit for an installment of his pay as a retired officer based on the theory that his service in the Naval Academy was within the definition of Civil War naval service referred to in an act fixing his pay. The judgment became final. The law, as applied to the undisputed facts, was in a suit by another claimant later held to have been erroneously determined. In a suit for a subsequent installment of his salary, Moser claimed that the question of right had been determined in the prior suit and the Supreme Court upheld this contention. It said:

"The contention of the government seems to be that the doctrine of *res judicata* does not apply to *questions of law;* and, in a sense, that is true. It does not apply to unmixed questions of law. Where, for example, a court in deciding a case has enunciated a rule of law, the parties in a subsequent action upon *a different demand* are not estopped from insisting that the law is otherwise, merely because the parties are the same in both cases. But a *fact, question or right* distinctly adjudged in the original action cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law. That would be to affirm the principle in respect of the thing adjudged, but, at the same time, *deny it all efficacy by sustaining a challenge to the grounds upon which the judgment was based.*"

United States v. Moser, 266 U. S. 236, 242, 69 L. ed. 262, 264.

It is of course elementary that the prior determination may defeat the second case although the causes of action are different, so long as the determination of the same question or right or fact is established.

Myers v. International Trust Co., 263 U. S. 64, 68 L. ed. 165.

However, it adds to the force of the plea when invoked against a new statute to show that as to relevant parts involved, the wording is the same. Such was the following case: A taxpayer obtained a judgment in one case that, in determining its net income, it was entitled to a certain deduction based upon the construction of the statute and regulations that were

then in force. The same deduction was claimed by the taxpayer under the new income tax acts which were cast in the same form and the Court noted that the regulations promulgated by the Secretary of the Treasury pursuant to the new acts were in the same form. The suit was for refund of taxes claimed to have been illegally collected by the government during a series of years. The taxpayer had claimed annually over a period of years as a deduction from gross income an amortized proportion of the discount on sales of certain bonds by certain companies. The Commissioner of Internal Revenue had disallowed the claimed deduction for the years 1918 and 1919 and the Board of Tax Appeals had sustained the ruling, but on a review the Circuit Court of Appeals for the Fourth Circuit had reversed the decision of the board. In its returns for 1923, 1924 and 1925 the deductions were claimed but were disallowed and the taxes were paid under protest. Suits were filed. The cases were consolidated. The taxpayer pleaded that the issue involved was *res judicata.* The point was sustained by the District Court and the Circuit Court of Appeals (62 F. (2d) 933). The Supreme Court of the United States granted a review, and upheld the defense of *res judicata.* We quote:

> "The scope of the estoppel of a judgment depends upon whether the *question* arises in a subsequent action between the same parties upon the same claim or demand or upon a different claim or demand. In the former case a judgment upon the merits is an absolute bar to the subsequent action. In the latter the inquiry is whether the point or *question* to be determined in the later

action is the same as that litigated and determined in the original action. *Cromwell v. Sac County,* 94 U. S. 351-353, 24 L. ed. 195-198; *Southern P. R. Co. v. United States,* 168 U. S. 1, 48, 42 L. ed. 355, 376, 18 S. Ct. 18; *United States v. Moser,* 266 U. S. 236, 241, 69 L. ed. 262, 264, 45 S. Ct. 66. Since the claim in the first suit concerned taxes for 1918 and 1919 and the demands in the present actions embraced taxes for 1920-1925, the case at bar falls within the second class. The courts below held the *lawfulness* of the respondent's deduction of amortized discount on the bonds of the predecessor companies was adjudicated in the earlier suit."

Tait v. Western Maryland R. Co., 289 U. S. 620, 623, 77 L. ed. 1405, 1407, 1408.

The Court also said:

"Is the *question* or *right* here in issue the same as that adjudicated in the former action? *The pertinent language of the Revenue Acts is identical;* the regulations issued by the Treasury remained unchanged; and of course the facts with respect to the sale of the bonds and the successive ownership of the railroad property were the same at the time of both trials."

Tait v. Western Maryland R. Co., 289 U. S. 620, 77 L. ed. 1405, 1409.

Note that the Supreme Court held that the "lawfulness" of the deduction had been determined. The acts were identical. The causes of action were different.

Freeman on Judgments, 5th ed., Sec. 672, states:

"If the existence, *validity* or *construction of a contract,* lease, conveyance or other obligation

has been adjudicated in one action it is *res judicata* when it comes again in issue in another action between the same parties, though the immediate subject matter of the two actions be different."

POINT VI.

RIGHTS VEST UNDER A DETERMINATION MADE BY A FINAL DECREE AND THE LEGISLATURE CANNOT DESTROY SUCH RIGHTS.

In a revision of its insolvency laws, the State of Massachusetts had divided the State into districts. The law designated the judges who might sit in insolvency cases in the event the local judge was unable to act. One of the judges had resigned. An outside judge was called in in an insolvency case but his selection was not in accordance with the statute. He proceeded to act. Certain creditors brought suit in the court of a supervisory jurisdiction and obtained an injunction against the carrying on of the insolvency proceedings and prohibiting the judge from acting. Later on the legislature of Massachusetts passed a law that purported to validate all of the proceedings which had been assailed. The Supreme Court of Massachusetts pointed out that the injunction judgment was final and that it was *res judicata* and that it was beyond the power of the legislature to defeat that judgment; that this would constitute an unauthorized interference with judicial power. The question was purely one of law.

Denny v. Mattoon, 2 Allen (84 Mass.) 361.

The case has been cited over and over again on the want of power in the legislative department to inter-

fere with judgments or judicial proceedings. Of a judgment the following case said:

> "If rightful the plaintiff therein had a vested right which no state legislation could disturb. It is not within the power of a legislature to take away rights which have been once vested by a judgment."
>
> *McCullough v. Commonwealth of Virginia,* 172 U. S. 102, 123, 43 L. ed. 382, 390.

POINT VII.

THE DOCTRINE OF RES JUDICATA IS ESSENTIAL TO AN ORDERLY JUDICIAL SYSTEM.

This point has been made clear.

Dated, Berkeley, California,
October 16, 1939.

Respectfully submitted,
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(Appendix Follows.)

Appendix.

Appendix

ASSIGNMENTS OF ERROR.

Various assignments of error cover the overruling of the plea of *res judicata.* Assignments of Error 71 to 92, inclusive, embraced every possible phase of the plea. Sufficient in the way of objection, however, was incorporated in Assignments of Error 82 to 92, inclusive, which read as follows:

"82. The Court erred in failing to find that those powers which were conferred upon the trial court by what is known as Section 83 of the Federal Bankruptcy Act are the same as the powers which Congress undertook to confer upon the said Court under Section 80 of said Act and that the appeal taken in said other proceeding by the non-assenting bondholders was in part upon the ground that the granting of the powers referred to was in excess of the power of Congress and could confer no jurisdiction upon the said trial court.

83. The Court erred in failing to find that the decree dated April 12, 1937, which is referred to in the aforesaid finding, was based directly upon and did determine that the grant of powers to readjust the indebtedness referred to, which powers the said trial court undertook to exercise, was in excess of the power of Congress and that this had been determined in the case of Ashton et al. v. Cameron County Water Improvement District No. 1, 298 U. S. 513.

84. The Court erred in failing to find that it was, by virtue of the said decree of the said United States Circuit Court of Appeals, finally and forever deter-

mined as between the petitioner herein and each and all of the dissenting bondholders, appellants herein, that the grant of powers contained in Section 83 of the Federal Bankruptcy Act, under which section this proceeding was begun and prosecuted, was unconstitutional and beyond the power of Congress to make, and that the trial court could not in reliance upon an identical grant of powers undertake to do substantially the same thing in the matter of readjusting the indebtedness represented by the bonds held by the dissenting bondholders as was attempted to be done in said prior proceeding.

85. The Court erred in failing to find that the decree entered by the trial court on the going down of the mandate following the making of said decree by said United States Circuit Court of Appeals was not a final adjudication and bar in favor of the dissenting bondholders to the same extent and in the same manner in which the said decree of the said United States Circuit Court of Appeals constituted an adjudication and bar against the petitioner.

86. The Court erred in failing to find that the decree last named became non-appealable and final because it was entered pursuant to the mandate of said United States Circuit Court of Appeals.

87. The Court erred in failing to find that the decree of said United States Circuit Court of Appeals was final.

88. The Court erred in failing to find that the decree entered upon said mandate was final.

89. The Court erred in failing to find that the petitioner herein was estopped, by virtue of the proceedings referred to in the preceding assignment and by virtue of the proceedings which are referred to in Finding VII of the Court, from asserting that the trial court did in this proceeding have the power to make any of the findings which subdivision (e) of Section 83 of the Federal Bankruptcy Act required it to find as a condition of its confirming or approving the petitioner's plan of debt readjustment.

90. The Court erred in failing to find that the particular issue as to the validity of the powers referred to in said subdivision (e) and the right of the trial court to exercise said powers were involved and were necessarily involved in the trial of said prior proceeding, and said issue was determined in favor of the dissenting bondholders in this case.

91. The Court erred in failing to find that the issues and the parties in the two proceedings were the same and that the subject matter or res in the two proceedings was the same and that the Court could not have been required to dismiss said other proceedings by the judgment of the Circuit Court of Appeals without a determination that there was no right in the petitioner district to have the debts involved in this case readjusted under alleged bankruptcy power of the kind attempted to be exercised in this case or under any type of bankruptcy power.

92. The Court erred in failing to find that the attempted exercise of power involved in this proceeding was the same as that involved in the prior proceed-

ing and that it had been finally adjudicated in favor of the dissenting bondholders that the obligations represented by their bonds could not be impaired or changed by the exercise of any so-called Federal Bankruptcy power or by the exercise of the particular powers mentioned in Section 83 of the Federal Bankruptcy Act."

Tr. pp. 297 to 300, Vol. II.

The designation of points also included an assignment of the point of *res judicata,* as follows:

"4. The cause is *res judicata.*"

Tr. p. 319, Vol. II.

THE EVIDENCE IN SUPPORT OF THE PLEA.

While this Court has held that in determining the plea, evidence must be introduced——

National Surety Co. v. United States (9th Ct.), 29 F. (2d) 92

—the Court will take judicial knowledge of its own records on the plea——

Divide Creek Irr. Dist. v. Hollingsworth (10th Ct.), 72 F. (2d) 937

—in which case it was said:

> "When the Supreme Court of the United States or other appellate tribunal, can end litigation by an examination of its own records, it is in the interest of justice that it do so."

In judging the plea of *res judicata* it is permissible to refer to the entire record of a prior proceeding to

determine whether a particular question was determined therein.

Oklahoma v. Texas, 256 U. S. 70, 88, 65 L. ed. 831, 835.

"It is well settled, however, that a decree is to be construed with reference to *the issues it was meant to decide.*"

Vicksburg v. Henson, 231 U. S. 259, 274, 58 L. ed. 209, 231.

The record on appeal by appellants in the prior proceeding consists of the printed record on the application of the district for a review by the Supreme Court of this Court's judgment in the prior proceeding.

Respondents' Exhibit "OO".

We specify the proceedings shown in said exhibit and by the printed transcript on appeal herein.

1. On April 19, 1935, the district filed petition under Section 80 to readjust its bonded indebtedness amounting to $16,190,000.00. Its plan was to pay off this debt at 51.501% of principal, the settlement to discharge any interest accruing on or after July 1, 1933, and the money to be supplied by a new bond issue to be taken by the Reconstruction Finance Corporation.

Respondents' Exhibit OO, pp. 9 to 40;
Filing date, page 41.

2. In said proceeding appellants appeared. They moved to dismiss and they pleaded the same ownership of bonds which they plead in this proceeding and they objected to the jurisdiction of the Court and as-

sailed Section 80 on various grounds, claiming particularly that the bankruptcy power did not extend to permitting a Court to interfere with the debts of a California Irrigation District.

The fairness of the plan was assailed on various grounds.

The motions to dismiss are described:

Ex. OO, pp. 43 to 47.

The answers are described:

Ex. OO, pp. 47 to 54.

3. Findings were filed *March 4, 1936.*

Ex. OO, pp. 228 to 249.

4. Decree was filed the same date.

Ex. OO, pp. 275 to 282.

5. A statement of the evidence was stipulated to as a part of the agreed statement on appeal.

Ex. OO, pp. 154 to 222.

6. Petition for appeal and assignment of errors were filed March 28, 1936, the assignments challenging the jurisdiction of the District Court.

Ex. OO, pp. 283 to 298.

7. Bond on appeal and order allowing appeal were filed March 30, 1936.

Ex. OO, p. 287.

Ex. OO, p. 302.

8. As there was some question as to whether this Court should allow the appeal, an additional order was applied for here and granted.

Ex. OO, pp. 304 to 325.

9. The Supreme Court of the United States, on *April 30, 1936,* decided the *Ashton* case.

Ashton v. Cameron Co. Water Improvement Dist., 298 U. S. 513, 80 L. ed. 1309.

On *October 12, 1936,* a rehearing was denied in that case.

10. The appellants moved to dispense with the printing of the record. This written motion concluded:

> "The said Act purports to confer *jurisdiction* on the United States District Courts to confirm and put into effect, as against non-consenting creditors, plans for readjustment of debts of municipalities and other political subdivisions, including Irrigation and similar Districts of any state.
>
> On May 25, 1936, the Supreme Court of the United States, in the case of Ashton, et al. v. Cameron County Water Improvement District No. One, 298 U.S. 513, decided and determined that said Act of Congress was unconstitutional and void. Said decision is now final.
>
> 2. Inasmuch as it has now been finally determined that said Act is unconstitutional and void, it follows that the District Court had no jurisdiction to render the decree appealed from, and it is in the interest of justice that, this court should dispose of the cause immediately."
>
> Ex. OO, p. 336.

11. The Court granted the motion, reversed the judgment and directed the trial Court to dismiss on April 12, 1937. The minute order, ordered the cause

reversed and directed that the trial Court enter judgment of dismissal.

Ex. OO, p. 338.

12. This Court's decree, dated April 12, 1937, followed said order.

Ex. OO, p. 339.

13. The mandate on the decree is set out.

Tr. pp. 962, 964, Vol. III.

14. The trial Court's decree of dismissal is dated July 6, 1937.

Tr. p. 967, Vol. III.

15. The petition filed June 17, 1938, herein presents the same plan. See Exhibit A of petition.

Tr. top of p. 29, Vol. I.

16. The district applied for certiorari and its application was denied on *October 11, 1937.*

Merced Irr. Dist. v. Bekins, 302 U. S. 709, 82 L. ed. 548.

17. The parties stipulated (Tr. p. 64) that only the pleadings of West Coast Life Insurance Company and of Milo W. Bekins et al., and of Mary E. Morris need be printed in full on this appeal and that other dissenting creditors had pleaded the same defenses.

Tr. p. 64, Vol. I.

In paragraph 4 of her answer respondent, Mary E. Morris, pleaded the bar and estoppel of the prior judgment.

Tr. pp. 73 to 80, Vol. I.

In its second separate defense, West Coast Life Insurance Company, did likewise.

Tr. pp. 50 to 52, Vol. I.

Milo W. Bekins et al. pleaded the same judgment.

Tr. pp. 121 to 123, Vol. I.

18. All respondents filed proof of claim.

Tr. p. 994, Vol. III.

19. At the trial the following stipulations were made:

> "It was stipulated that it was obvious that only one mass of bonded indebtedness of $16,190,000 involved in this proceeding was involved in the former proceeding in this court.
>
> It is further conceded that it was stipulated that the various dissenting bondholders owned the bonds which they claimed in their pleadings to own in the other proceeding in this court.
>
> It is further admitted that the bonds, the ownership of which is pleaded in the pleadings in the first case, are the same bonds the ownership of which the respondents plead in this case, except that in this case the respondents plead, in addition, accruing interest upon the bonds.
>
> It is further stipulated that the Supreme Court of the United States ruled upon the petition for writ of certiorari in October, 1937."

Tr. p. 542, Vol. II.

It was stipulated that objection to jurisdiction was made throughout the prior proceeding.

Tr. p. 541, Vol. II.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District ~~and Reconstruction Finance Corporation~~,

Appellees.

BRIEF FOR APPELLEE MERCED IRRIGATION DISTRICT.

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BRIEF FOR APPELLEE MERCED IRRIGATION DISTRICT.

SUPPLEMENTAL STATEMENT OF CASE.

The following supplement to appellants' statement of the case will clarify the issues involved.

Default and Attempts to Refinance.

Prior to actual default of the district it was clear that default was imminent and in the spring of 1931 the bondholders began to organize for the protection of their investments (R. 495). Since that time and up to the present, the history of the district has been one of constant refinancing negotiations. From the outset it was recognized

by the district and bondholders alike that refinancing was necessary. The only difference of opinion was as to the manner in which it should be accomplished (R. 495, 496). The cash offer of $515.01 for each $1000 bond was the final culmination of the efforts of the bondholders to protect their investments before all value should be destroyed. It became possible only after Congress had authorized Reconstruction Finance Corporation* loans to effectuate irrigation district reorganizations.

At the first conferences in 1931 the bondholders appeared informally. Subsequently two bondholders' protective agencies were formed (R. 495). Later these two agencies were merged into what is known as Merced Irrigation District Bondholders' Protective Committee which subsequently carried on elaborate negotiations with the district (R. 495-509). Either individually or through their protective committee or as a group of dissenting bondholders it may be said that since the first default in 1931 the security holders have actively and aggressively been seeking to preserve the value of their bonds to the full extent justified by the economic condition of the district. It would not be accurate to say that at all times the district and bondholders agreed, but it is true that the district to the best of its ability has cooperated with the bondholders in an effort to elicit all relevant facts and to put the district on an "ability to pay" basis.

*Referred to throughout this brief as R. F. C.

Investigations and Studies.

The record shows the most comprehensive investigations and surveys of the district by engineers, auditors and agricultural experts. These studies were made either by the bondholders alone, or, as in the case of the Benedict economic report hereafter referred to, jointly by the bondholders and the district. The district paid all of the expenses (R. 372). In addition many of the bonds were held by banks, and large corporations which had at their finger tips resources of statistical organizations, and from 1931 these were utilized to determine the maximum load the district could carry.

A letter from the bondholders' committee to the bondholders dated December 15, 1933 (Ex. 37, R. 736), gives a vivid picture of the extent and nature of these studies and what they revealed as to the district's critical financial condition as of that time. The basic reasons underlying the district's inability to carry its bonded debt are also graphically set forth. They are referred to later.

During the early negotiations every attempt was made to marshal the facts carefully but natural differences of opinion developed and by the early part of 1932 it was deemed desirable to have an economic study made by a thoroughly competent and impartial agency in order to determine the taxpaying abilities of the lands in the district. Accordingly a joint request was made on the University of California by the district and the bondholders' committee to make such study (R. 434) and what is known as the "University of California", or the "Giannini Foundation" or "Benedict" report was the result. We shall hereafter refer to it as the Benedict report.

The Benedict Report on Tax Paying Ability.

Dr. Benedict, an agricultural statistician with a national reputation, was in charge (R. 432-435), and under him was a group of experienced assistants aided by a fact finding committee. In addition Mr. Robert Fullerton, Jr., vice president of the bondholders' committee and director of the Citizens Commercial Trust and Savings Bank of Pasadena (R. 508), representing heavy bondholdings, was appointed by the bondholders' committee to serve as an observer. Arrangements were also made by the bondholders' committee with R. L. Underhill, an engineer, to act as an observer with J. S. Cone in classification and appraisal of the lands (R. 435). The report was completed in about nine months of intensive work (R. 435). It is an outstanding, scientific study of tax paying ability and was introduced in evidence with the testimony of Dr. Benedict (R. 432, et seq.) as Ex. 35. It is a separate volume in this record of about 133 printed pages.

At the inception of the study the lands in the district were first classified and appraised by Mr. Cone with Mr. Underhill acting as observer. The classification and appraisal is set forth at pages 126 to 130 of the Benedict report (Ex. 35). It was found there was no market value for the lands in the district as of that time. The few buyers of farm lands had gone elsewhere. To set any value at all upon the lands it was necessary, among other things, to assume:

(a) that within a reasonable period of time a settlement permanent in its nature between the bondholders and the district should be arrived at based upon "ability to pay";

(b) that there would be an upward revision of farm product prices reaching a level fairly comparable to the price levels of 1910 to 1914;

(c) that the district should be able to control the increasingly high water table and that the rapid spread and growth of noxious weeds and grasses should be abated (Ex. 35, p. 127).

Based on these assumptions, a value of $100 per acre was placed on all lands graded at 100% and values on the rest of the lands in proportion to their percentage gradings. Grade One included all lands of 85% and above; Grade Two, 60% to 80% and Grade Three, all lands under 60% (the marginal areas). The result showed the following:

Grade I	38,607	acres
Grade II	52,151	"
Grade III	80,852	"
Total	171,610	"

(Total value $10,518,307 on the assessment roll) (Ex. 35, pp. 128-130).

The testimony of Dr. Benedict and his report showed that as a "net-over-costs" for out-of-pocket cash expenses, labor and county taxes for the years 1929-30-31, all of the property in the district being farmed, as an average, operated at a loss for said three years with the exception of the Grade One lands in 1929. Taking the same figures for the same three years but including depreciation, all the properties were being farmed at a heavy loss (R. 437; Ex. 35, pp. 68-69). His study further showed that

for 1926-27-28 all of the properties were being farmed at a heavy loss (Ex. 35, pp. 114-124). On the properties selected as a sample, for 1926-27-28 the total net income before the payment of taxes and irrigation assessments was minus $246,872; net income after taxes and assessments for the three years was minus $1,389,019 (R. 440-441). Most of the assessments that were paid were not being "yielded" by the lands (R. 441, 442, 456). In "considerable part" they came from outside sources (R. 442). They were based on hopes and prayers for later improvements in value. Dr. Benedict's study and report covered six years of operations but was designed to show what the district should be able to pay in irrigation assessments over the period of the bond issue. 1926-1930 were good agricultural years—better on the whole than the years that followed (see index figures for California Farm Prices, R. 436, also Report U. S. Dept. Agriculture, Ex. 34, R. 733).[1]

At the trial the witness Momberg (manager of California Lands, Inc., at Merced, a heavy operator in the district) further supplemented and confirmed Dr. Benedict's evidence. His testimony covered the years subsequent to 1932 up to and including the year 1938 (R. 472) and showed substantially the same situation for those years that Dr. Benedict had found for 1926-1931. Thus practically the entire period that the district has been operating was covered by the testimony of these two witnesses.

---

1. Through error the U. S. Dept. of Agriculture Report inserted in the record did not include the latest one issued up to the date of trial, Nov. 1, 1938. The index figures for 1938 are quoted in Appendix "A". The court takes judicial knowledge of the report.

We pause to remark that an irrigation district cannot be operated successfully unless the farmer can operate the land to make a profit and pay taxes. Unless he can be kept on the land and assessments kept within "ability to pay" default is inevitable. The Benedict report and the early investigations made by the bondholders themselves show that payments did not come from the land but from outside sources. When these were exhausted it was obvious that collapse would follow and that is why from the very first it was recognized that refinancing was essential (R. 495, 496).

Bondholders' Letter of December 15, 1933.

The letter of the bondholders' committee to the bondholders dated December 15, 1933 (Ex. 37, R. 736) states that there are approximately 90,000 acres in the district that may be classified as "good lands" and 80,000 acres which taken as a whole, are not able to carry a substantial part of the district's obligations. Of the 90,000 acres of good land it is stated there are some 17,000 acres above the level of the gravity distribution of water in respect to which the delivery of water is largely at a loss, leaving approximately 74,000 acres upon which the burden of the district's obligations largely rests (R. 742; see, also, R. 516).

Other factors contributing to the default according to this letter were the inability to colonize the district, and the irregularity of annual power revenue.[2]

2. This varied from a low of approximately $95,000 in 1931 to a high of approximately $707,000 in 1938 (R. 407).

The letter is signed, among others, by Milo W. Bekins, Reed J. Bekins, Victor Etienne, Jr., Honorable James N. Gillett and Myford Irvine, who appear in the pending proceeding either personally or in a representative capacity as dissenting bondholders and appellants holding a large volume of the dissenting bonds (R. 5, 501, 505, 885).

In addition, the following should be noted: First, the district was grossly over-capitalized. At the inception of the project $5,500,000, or over one-third of the total bond issue, was expended to relocate the Yosemite Valley Railroad (R. 510). From the standpoint of economic return this represented no useful purpose and was a total loss; also, there has been an inability to sell property taken over by the district for delinquency (R. 512). Some improvement is noticeable recently in the market for sale of the district's lands based on the assumption that the refinancing will be completed at the R. F. C. price. If the outstanding issue of $16,190,000 were serviced, the resultant delinquency would plainly make all sales impossible.

First Refunding Plan.

In the latter part of 1933 and after the Benedict report had been received and studied, the district and the bondholders' committee informally reached an agreement on a refunding plan (Ex. 37, R. 737) which the district officially approved at an election (R. 512). This plan will be spoken of as the "first refunding plan." It is also spoken of in the testimony as the refunding plan of 1933 (R. 499). It contemplated that the old issue of $16,190,000 would be exchanged for refunding bonds in the same principal

amount, all to become due simultaneously in fifty years, namely, in 1983 (Ex. 37, R. 749). In other words, there was to be an exchange of one bond for another of the same principal amount and with no change in interest except for a seven year period during which the fixed interest was reduced and contingent interest was provided for (Ex. 37, R. 748). It was further agreed the district was to apply for federal or state aid "in the repurchase or refinancing" of the bonds in the event funds were made available from a "Federal or State agency" (R. 752).

Prior to the informal agreement on the first refunding plan the bondholders' committee had been accepting deposit of bonds under a deposit agreement dated March 1, 1932 (Ex. 11, R. 576). Under the terms of this deposit the committee could adopt such plan of refinancing as it saw fit but any bondholder upon being notified of the plan could withdraw his bonds within a period of thirty days upon payment of his prorata of the committee's expenses (Ex. 11, R. 576-578). When the first refunding plan was informally agreed to there were about 35% of the bonds on deposit with the committee pursuant to the agreement of March 1, 1932 (R. 737).

Upon approval by the district of the first refunding plan, the bondholders' committee employed men to solicit deposit of bonds under the plan (R. 496). The bondholders were advised, however, that additional outstanding bonds had to be deposited with the committee to enable it formally to adopt the plan (Ex. 37, R. 737). They were also told that the committee would cooperate in any application to secure federal or state aid. It was clear

that no bank or underwriter would advance money to refinance the district and any cash must come from relief agencies of the state or federal government. Until money should be so made available a paper exchange was the only way to refinance, although of course essentially that gave the bondholders nothing.

It also became increasingly clear as time went by that the first refunding plan would not be accepted by a substantial percentage of bondholders. Over a year later, notwithstanding intense solicitation in the meantime for the first refunding plan, "just short of 60%" (R. 499, 497) of the bonds had been deposited (not 80% as appellants say p. 6 of their brief[3]), whereas within a few months after the adoption of the cash plan by the committee on February 15, 1935 (R. 586) nearly 90% of the bonds were deposited (R. 344). Furthermore, it became obvious almost immediately after the first refunding plan had been approved by the district that it could not carry it out. The district attempted to operate under it but in less than a year defaulted to the extent of about $390,000 (R. 512).

R. F. C. Loan and Cash Plan.

In the meantime district representatives went to Washington and made application for an R. F. C. loan (R. 497). On November 14, 1934, a resolution was passed approving a loan (Ex. OO, 155) which would enable the district to pay $515.01 for each $1000 bond. The amount of the loan was, of course, based on a careful appraisal

3. All references to appellants' brief are to their main brief unless otherwise noted.

of the "loan value" of the district based upon its "ability to pay." It was necessarily higher than the maximum loan value to a private banker or underwriter[4] because the R. F. C. lends at 4%. This lower cost of money is reflected in a decreased cost of bond service to the landowner, making it possible for him to carry a higher loan. For example, a $3.00 tax rate (which we will assume represents the "ability to pay" rate) might service a bond issue at 4% to the R. F. C. but it would not service a bond issue in the same principal amount at 6%.

The agreement of the R. F. C. to make the loan, however, was subject to certain conditions which, among other things, provided for purchasing and keeping the old bonds alive until all had been deposited for refinancing (Ex. OO, 159 (b), 164 (c), 165 (d)). These terms and conditions will be discussed later in detail under Proposition Two. The district accepted the resolution and the terms and conditions thereof on December 11, 1934 (Ex. OO, 180) and on February 11, 1935, adopted a refunding plan based thereon (Ex. OO, 183, and note p. 189 (3)) which was later approved by the electors of the district (Ex. 14, R. 603-606).

The district submitted the cash offer of $515.01 for each $1000 bond to the bondholders' committee (R. 496) and to the bondholders (R. 761). There followed considerable negotiations and discussion culminating in a referendum which the committee submitted to the bondholders.

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4. There is no evidence of any private banker or underwriter being willing to refinance at any price.

Referendum on Cash Plan.

By this referendum the bondholders were asked whether they preferred the so-called first refunding plan (exchanging their bonds for another bond due in fifty years) or cash in the sum of $515.01 for each $1000 bond (R. 499). The holders of $10,221,000, or approximately 63% of all bonds outstanding, voted in favor of the cash plan and $1,147,000, or 7% of bonds outstanding, voted for the refunding plan of December 1933 (R. 499), a majority of nearly ten to one in favor of cash. In number of bond holders, 658 voted in favor of the cash plan and 141 in favor of the refunding plan of December 1933, nearly five to one in favor of cash. Fifty-eight expressed no preference (R. 503). Not the committee, therefore, but the bondholders themselves by an overwhelming majority expressed the choice.

February 15, 1935, the bondholders' committee, on the basis of the referendum officially approved the cash plan and notified all depositing bondholders they could withdraw their bonds within thirty days upon payment of their proportion of the expenses of the committee, otherwise the committee would deposit all bonds in its hands under the cash plan (Ex. 13, R. 586-596). About 2% withdrew (R. 499). Two months later (April 18, 1935) 75% of the bonds had been deposited under the cash plan (Ex. OO, 23, 40) and the district filed a proceeding under Section 80 of the Bankruptcy Act for confirmation (R. 518). This is called the first bankruptcy case.

Purchase of Deposited Bonds by R. F. C.

On October 4, 1935, there were approximately $14,071,000 of bonds on deposit under the cash plan (R. 344). Thereupon the R. F. C. authorized purchase of all deposited bonds at the settlement figure (R. 344 and Ex. 10, R. 557) pursuant to an agreement with the district dated August 14, 1935 (Ex. OO, 217). (See, also, agreement of September 16, 1935, Ex. OO, 202).

Under the first named agreement the R. F. C. was to purchase all deposited bonds. The district bound itself "expeditiously and in good faith" to continue to secure deposit of bonds until all of the old bonds were available for refinancing. In the interim the bonds purchased by the R. F. C. were to continue as outstanding obligations for the full amount thereof. Upon presentation or deposit of all of the outstanding bonds at the settlement figure, refinancing was to be completed by cancellation of the old bonds and issuance of refunding bonds to the R. F. C. An interim interest payment of 4% annually to R. F. C. on the money used to purchase the old bonds was agreed to. Detailed discussion of the legal relations of the R. F. C. and the district is set forth in the answer to First Proposition.

To date refinancing has not been completed because the dissenting bondholders have not turned in their bonds. Hence the old bonds continue as outstanding obligations. They have not been cancelled or surrendered nor have refunding bonds been issued to the R. F. C. (R. 361). All old bonds, however, are purchased by the R. F. C. whenever offered at the settlement figure (R. 351).

Pursuant to instructions from the R. F. C., dated September 19, 1935 (Ex. 10, R. 557), the Federal Reserve Bank on October 6, 1935, proceeded to purchase the deposited bonds for the account of the R. F. C.

The cash plan provided that, in addition to the $515.01 for each $1000 bond, depositing bondholders should be paid by the district 4% on the settlement figure from the date of deposit until funds should actually be made available to take up the deposit (Ex. 13, R. 586-591). In other words, during the period that the bondholder had surrendered his bond and until money was available to fulfill the conditions of the escrow, he was to receive 4% upon the liquidating figure (R. 354, 367).

Money became available on October 4, 1935 and ever since has been available at the settlement figure (R. 351). But from the date of deposit under the cash plan until October 4, 1935, interest accrued on deposited bonds from varying dates at 4% on the settlement figure, totaling $168,027.31 (R. 368). This interest was paid by the district pursuant to the cash plan at the time the R. F. C. made disbursement on October 4, 1935 (R. 368). No interest has been paid to depositing bondholders since that date as the R. F. C. has continued to take up bonds pursuant to the cash offer whenever presented (R. 351). The district has, however, made the interim payments of 4% annually to the R. F. C. (R. 764).

Proceedings After Purchase of Bonds by R. F. C.

The trial of the first bankruptcy action under Section 80 was held in February 1936 (R. 518). The plan was confirmed (Ex. OO, 222). Dissenting bondholders ap-

pealed (Ex. OO, 324). Before the record was printed, the Supreme Court in *Ashton v. Cameron County Water Improvement District,* 298 U. S. 513, 56 S. Ct. 892, 80 L. Ed. 1309, held Section 80 of the Bankruptcy Act unconstitutional. Thereafter on the 17th day of March, 1937 dissenting bondholders made a motion to dispense with printing of the record and to reverse the case on the authority of the *Ashton* case (Ex. OO, 333). This motion was granted by the Circuit Court of Appeals April 12, 1937 (Ex. OO, 338), 89 Fed. (2d) 1002. The district then filed a petition for certiorari which was denied by the Supreme Court October 11, 1937 (R. 519), 302 U. S. 709, 58 S. Ct. 30, 82 L. Ed. 548). Thereafter the case in the District Court was dismissed for want of jurisdiction. It is claimed by appellants that this judgment is *res judicata* here.

In the meantime and prior to the enactment of Sections 81-84 of the Bankruptcy Act on August 16, 1937, the State of California on March 30, 1937, enacted what is known as the Irrigation District Refinancing Act (Stats. 1937, Chap 24). That Act provides that an irrigation district may, with the consent of two-thirds in amount of its creditors, present a plan of refinancing and if the court, among other things, finds the plan fair, public necessity for the condemnation of the dissenting bonds is found and thereafter the case proceeds as a condemnation action. On July 20, 1937, the district filed under that Act in the Superior Court in Merced and the case proceeded to trial in January 1938 (R. 519). In March 1938, the court handed down an opinion that the plan was fair (R. 381) and directing the preparation of an interlocutory

judgment pursuant to the Act (Sec. 8) which, if entered, would have established the right to condemn. No findings or judgment, however, was entered (R. 384) and nothing further has been done because on April 25, 1938, the United States Supreme Court in *United States v. Bekins,* 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137, held Sections 81-84 constitutional. Accordingly the district elected on June 17, 1938, to proceed under this Act in bankruptcy and filed this proceeding (R. 8, 36).

In closing this general summation it should be stated the evidence shows without any doubt that the district was hopelessly insolvent and unable to meet its debts as they matured. Not one of the dissenting bondholders seriously asserted at the trial that the district could pay its bonded debt of $16,190,000 plus millions of dollars in defaulted interest. The legal tax rate in September, 1939, if an attempt were made to service the old bond issue, would be $68.83 per $100 assessed valuation (R. 402; Exs. 22, 23, R. 661-663). The district defaulted 62.80% on its last attempt to levy for bond service in September 1932 (R. 402). At that time the rate was $8.90 per $100 and the current amount then required for bond service was $954,400, whereas the peak amount required for bond service would not be reached until the year 1951 when $1,280,700 would have to be raised (R. 404, and note Ex. 24, R. 666, photostat of chart representing bond service costs to date of maturity old bond issue).

Fortunately the "pyramiding" of delinquencies which results in the virtual disappearance of the landowner from the district *(Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365 at 371) and under which the "power of

taxation'' becomes ''useless'' and the ''creditors of the district'' become ''helpless'' (per Chief Justice Hughes in the *Bekins* case *supra,* 82 L. Ed. at 1145) and under which annual assessments in each succeeding year ''fall upon a progressively lessening body of land'' which in turn is ''forced to default in greater and greater quantities'' thereby destroying the ''ability of such districts to pay their bonded debts in whole or in part'' (R. 429-432) stopped with the levy of the assessment in 1932 (R. 409). Following the delinquencies of 62.80% on that levy, the district availed itself of emergency legislation which permitted the levy of an emergency rate in accordance with the ability of the land to pay and as approved by the California Districts Securities Commission (Sec. 11, Cal. Stats. 1933, Chap. 60, Chap. 36 Stats. 1935, R. 402).[5] The emergency rates since 1932 have been as follows: 1933, $1.00; 1934, $1.70; 1935, 1936, 1937 and 1938, $3.00 per $100.00 (R. 403).[6] Based on this lowered assessment rate the law of diminishing returns has been reversed, the vicious circle resulting in pyramiding has been broken and delinquencies have dropped materially. In addition, landowners have taken advantage of emergency legislation permitting ten year installment payments on past delinquencies (R. 405). The lowered tax rate, coupled with very high revenue from sale of power for three years, has resulted in improved conditions in the financial affairs of the district. This improved condition, however, is due to the fact that the district, for practical purposes, has been operating as if the R. F. C. refunding plan were in

5. Extended by subsequent amendments.

6. For reports of the Districts Securities Commission showing that these rates are based on "ability to pay" and confirming them (see Exs. 29 to 33A, R. 678 to 732).

effect and no futile and dangerous attempt has been made to service the outstanding bond issue of $16,190,000.

No plan of refinancing, except the cash plan, ever met with substantial approval of the bondholders. In fact, no other plan was even seriously suggested except the "first refunding plan" which the bondholders themselves rejected (R. 499) and which experience showed at the very inception to be unworkable and impossible for the district to carry out (R. 512, 514).

The bonds of the district were selling as low as sixteen and eighteen cents on the dollar prior to the time that R. F. C. granted the loan (R. 500). And it is a fair deduction from the evidence that they would have little or no value except for the underwriting of the cash plan by the R. F. C. In other words, the plan of composition does not take from the bondholders any of the value of their bonds. In large degree that was already gone. The cash plan and the support accorded by the R. F. C. gave the bonds a value they would not otherwise have had and enabled the bondholders to salvage over 50% of a principal investment which had largely been lost.

So clear was the testimony (1) that refinancing was necessary if anything were to be salvaged on the bonds, and (2) that the cash plan was the only practicable refinancing plan, that appellants primarily present their case on the claim that the district has already been refinanced through the operation of the R. F. C. and the old bonds purchased by it have, in effect, ceased to be outstanding obligations and have been cancelled. Therefore, it is argued that the principal debt structure is not $16,190,000 but the amount of the dissenting bonds in full in the principal sum of $1,488,000 plus $7,570,871.60

used by the R. F. C. to buy up deposited bonds (Ex. AA, R. 888), making an alleged total principal debt structure of $9,058,871.60. It is then argued that the district has the ability to pay a debt of this amount, thereby giving appellants payment of their bonds in full and proving (so it is claimed) that the district plan (if not appellants' reasoning) is unfair. But the major premise finds no support in law, logic, equity or fair dealing and, as we shall see in the next subdivision hereof, is utterly at variance with the contracts and intention of the parties and with the admitted facts.

ANSWER TO FIRST PROPOSITION: "THE RECONSTRUCTION FINANCE CORPORATION IS NOT A CREDITOR AFFECTED BY THE PLAN OF COMPOSITION AND ITS CONSENT IS NOT ENTITLED TO BE CONSIDERED."[7]

A. The Court Found the Bonds are Owned by the R. F. C. and are Outstanding. The Issue is Primarily One of Fact, Not of Law.

The trial court (25 Fed. Sup. 981; R. 168) held that the clear effect of the evidence is that the R. F. C. is a creditor in the full amount of the bonds purchased; points out that unconditional bills of sale were given to it except in a few instances where they were waived; that all bonds so acquired were duly registered in its name as owner and since their delivery have been subject to its sole control. It finds that the clear intent of all parties was that the

7. Since the writing of the following section of this brief the Supreme Court on November 6th denied certiorari in *Luehrmann v. Drainage District No. 7*, 104 Fed. (2d) 696. This case is reviewed at pages 55 et seq. infra, but aside from other considerations advanced there, the case is direct authority that the R. F. C. is a creditor affected by the plan in the full amount of the bonds held by it. All contentions of appellants relating to R. F. C. status are answered by this case. Ours is even a stronger case since there the bonds were admittedly held in pledge. If the *Luehrmann* case is accorded full weight it renders consideration of the following section by the court unnecessary. We therefore cite it at the beginning.

bonds were to be kept alive and available for further protection of the R. F. C. until such time as it concedes that refinancing is complete. The formal findings of fact were to the same effect (R. 214-215). There was ample evidence to sustain these findings. In fact, it is difficult to understand how the evidence would have sustained a contrary finding. The trial court says, at page 984, R. 171:

> "No one can read the record of the negotiations between the governmental agency and the insolvent District and its security holders and fail to conclude that the paramount, imperative and essential feature of the contract was the ultimate and not the immediate retirement of the outstanding bonds which the R. F. C. acquired."

B. The Evidence Sustains the Finding.

Briefly summarized, the evidence showed the following: On November 14, 1934, the R. F. C. passed a resolution authorizing a loan to or for the benefit of the district "subject to * * * conditions" (Ex. OO, 157). Disbursement was to be made——

> "to or for the benefit of the Borrower *through the purchase of securities*[8] issued or to be issued by the Borrower or upon promissory notes collateraled by the obligations of the Borrower * * *" (Ex. OO, 159(b)).
>
> "All or any part of the Old Securities acquired or held * * * through any disbursement * * * as well as all rights in or to such Old Securities may be kept alive for a greater or lesser time and for any purpose the Division Chief and Counsel may deem necessary" Ex. OO, 164(c)).

8. Emphasis ours in this brief except as otherwise noted.

"* * * Until such Old Securities have been exchanged for New Bonds, all such securities as well as all rights in or to the same shall continue to be and constitute obligations of the Borrower for the full amount thereof and nothing in this resolution shall be deemed to limit the right of this Corporation to enforce or cause to be enforced full payment of principal and interest of such Old Securities as and when the Division Chief and Counsel shall deem it advisable to do so * * *" (Ex. OO, 164-165).

The resolution further provides that the borrower will annually levy and collect assessments sufficient to pay the principal and interest upon the old securities according to their tenor and effect during the time any of the old securities are held by or on behalf of the R. F. C., except as waived by the Division Chief (Ex. OO, 165(d)).

On February 11, 1935, the district passed a resolution for the refunding of its old securities. Paragraph 3 thereof (Ex. OO, 189) provides as follows:

"3. As provided for in said Corporation Resolution, the District hereby promises, covenants and agrees with said Reconstruction Finance Corporation to the effect that so long as any of said new bonds or any of the old securities pledged with or acquired by Corporation remain outstanding, said District will duly and fully fulfill, comply with and carry out all of the terms and conditions on its part to be fulfilled, complied with and carried out under the terms and conditions of said Corporation Resolution, and further that said District will at all times levy and collect sufficient assessments to pay all expenses of operating, maintaining and repairing its works, all sums necessary for payment of interest and principal on

the bonds and any other indebtedness at any time owed by the District * * *'' (Ex. OO, 189).

The foregoing resolutions are preliminary but carefully provide for keeping the old securities alive.

The formal agreements between the parties are found in the Record (Ex. OO) at pages 202, et seq. and 217 et seq. The first of these, dated August 14, 1935 (Ex. OO, 217) is one under which disbursement was made by the R. F. C. on October 4, 1935 (R. 344). Under this agreement the district agrees to bring about the participation of *all* the old securities in the refinancing plan (Ex. OO, 218). The R. F. C. agrees to make disbursement ''for the purpose of acquiring any portion of the old securities'' which may be available for refinancing (Ex. OO, 219). It is then provided as follows:

> ''2. Until the Old Securities acquired and held by the Corporation by reason of or in connection with such disbursements, are exchanged for New Bonds issued by the District, or are otherwise refinanced as provided in the Resolution, they shall at all times continue to be and constitute obligations of the District for the full face amount thereof.'' (Ex. OO, 219.)

Paragraph 6 provides as follows:

> ''6. During the time the Corporation holds any of the Old Securities and the same have not been refinanced by the issuance and delivery of New Bonds or as otherwise provided in the Resolution, the District will annually levy and collect taxes and assessments in sufficient amounts to pay, and will pay, the Corporation each year a sum that will yield to the Corporation four per cent upon the total amount of

> the disbursements made to or for the benefit of the District in acquiring such Old Securities, or rights or interest in or to the same; provided, that the Corporation can, during any such time, require the District to pay any larger sum not exceeding the amount due on said Old Securities according to the terms thereof, in which event the District will so levy, collect and pay such larger sum." (Ex. OO, 220.)

The agreement of September 14, 1935 (Ex. OO, 202 et seq.) is the formal agreement in which the R. F. C. agreed to purchase the refunding bonds of the district. It relates primarily to the refunding bonds except as follows:

> "* * * R. F. C. may, in its discretion, keep any part of said indebtedness alive, for the sole purpose of maintaining a parity between itself and the holders of indebtedness of said Borrower who have not agreed to enter into the refinancing scheme of said Borrower, or for any other purpose." (Ex. OO, 203.)

Pursuant to the above noted agreement of August 14, 1935, the R. F. C. wrote to the Federal Reserve Bank to purchase for its account bonds which had been deposited for refinancing (Ex. 10, R. 557). Formal bills of sale for $14,071,000 were executed to the R. F. C. (R. 344; Ex. 11, R. 574) in accordance with the form memorandum of sale attached to Exhibit 10 (R. 571). The balance of the bonds have been sold to the R. F. C. "over the counter" (R. 348). At the time of trial it held $14,702,000, or 90.802%. All bonds have been registered in the name of the R. F. C. as owner (R. 349). These bonds have been held by the Federal Reserve Bank subject to sole control of the R. F. C. (R. 349-350). No refunding bonds or

promissory notes have been issued by the Merced Irrigation District or delivered to the R. F. C. (R. 361).

The foregoing testimony was not denied. It is asserted however, that the contracts do not mean what they say in respect to keeping the old bonds alive. Testimony was also offered by appellants as to the correspondence and conduct of the parties which, so they allege, served to nullify the agreement that the old securities would remain uncancelled. Actually the testimony offered by appellants on this point did no such thing and furthermore it was rebutted by petitioner (R. 361-366, 385-398) and could not at most do more than to raise a conflict which the trial court resolved in favor of petitioner. Appellants say the evidence offered by them shows that the R. F. C. and the district have repeatedly acknowledged that the indebtedness of the district to the R. F. C. is the purchase price of the bonds, not the old bonds. This is not true. Nothing in the record justifies the assertion that the R. F. C. has waived its right to enforce the old bonds in full. It is true that in certain correspondence between employees of the district and the R. F. C. the transaction is sometimes spoken of as a "loan" and properly so (it was a *conditional* loan). Generally though, the letters referred to a "purchase" (Exs. 20 and 21, R. 652 et seq.). In some of the letters or documents written by employees of the R. F. C. the old bonds are loosely referred to as "collateral" or "security" and the money used to buy old bonds as an "advance".

But of course it is of no consequence what phraseology employees or third persons may use in attempting to describe this rather complicated transaction. The solemn

and official obligations of the two contracting parties, governmental agencies both, are set forth in their contract and are not to be nullified by collateral letters or documents of this type.

Nor do the books of the R. F. C. show any waiver of the old bonds. The items of principal indebtedness referred to by appellants on page 20 of their brief are those set forth in a questionnaire the form of which was submitted by the R. F. C. to the district. In the form the district is expressly instructed "*Do not include outstanding bonds of issues to be refinanced*" (R. 778). Contrary to the claim of appellants this is not an admission that the old bonds have been extinguished but an assertion that they are outstanding and are to be refinanced.

In sum, the evidence really showed without conflict that the contract of the parties was this:

The R. F. C. agreed to loan money to the district to refinance its bonded debt (*all* of its bonded debt) at $515.01 for each $1000 bond. The loan was subject to certain conditions one of which was that all old securities should be purchased and held by the R. F. C. at full value —in other words, kept alive and outstanding—until the R. F. C. was satisfied refinancing was complete. At that time the R. F. C. agreed to buy and accept refunding bonds subject to the contract of September 14, 1935 (Ex. OO, 202). Then and only then the old bonds were to be surrendered and cancelled.

The legal relationship of the parties is carefully defined not only as it is to be after a permanent status is reached, that is to say, after the refunding bonds are issued to the R. F. C. but also as it is to be during the "interim" or

"temporary" period when the transaction necessarily could not have reached its "permanent" or "final" form. In every controlling resolution and contract it is stipulated the old securities are to be kept alive pending completion of refinancing. And the payment of 4% to be made by the district on the money used by the R. F. C. to purchase bonds is clearly an "*interim*" payment for the use of new money put into an insolvent enterprise by a third party for the benefit of the debtor and its creditors.

Appellants seek to "label" the contract between the district and the R. F. C. as a "loan" and then to pour it into a legal "mould" from which it emerges with static legal attributes. This is what has been aptly called the "tyranny of labels". Judge McCormick in his opinion in *In re Lindsay-Strathmore Irr. Dist.*, 25 Fed. Sup. 988, at 991, answers it conclusively when he says that the mere use of such terms as "loan", "pledge" and "collateral security" does not "*ex proprio vigore*" determine what the "contractual relationship" is.

What appellants really assert is the right to determine for the R. F. C. when refinancing is complete. They not only seem to claim that the contracts were made for the benefit of themselves, but that they have the right to make the election for the R. F. C. as to when the "major part" of the old bonds have been refinanced.

C. The Bankruptcy Act Clearly Makes the R. F. C. a Creditor in the Full Face Amount of the Bonds Purchased.

Chapter IX of the Bankruptcy Act sets up the structure for composition of debts of public agencies and fixes the rights of the parties here. See recent cases of U. S. Supreme Court, as follows:

City Bank & Farmers Trust Co. v. Irving Trust Co., 299 U. S. 433, 57 S. Ct. 292, 81 L. Ed. 324, holding Congress has the right to define the term "creditors" and the claims provable.

Schwartz v. Irving Trust Co., 299 U. S. 456, 57 S. Ct. 303, 81 L. Ed. 348;

Meadows v. Irving Trust Co., 299 U. S. 464, 57 S. Ct. 307, 81 L. Ed. 353;

Wright v. Union Central Life Ins. Co., 304 U. S. 502, 58 S. Ct. 1025, 82 L. Ed. 1490.

As these cases point out, Congress is authorized under the bankruptcy power to cover nothing less than the entire subject of the relations between an insolvent or nonpaying debtor and his creditors extending to his and their relief. If the English language means anything at all Congress intended the R. F. C. to be a creditor for the full amount of the old bonds. In fact this case and others similar in nature were doubtless before Congress when the act was passed.

Section 82 defines "creditor" as the "holder of a security or securities" and "any agency of the United States holding securities acquired pursuant to contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof". Also, subparagraph (j) of Section 83 provides that the partial completion or execution of any plan of composition by the exchange of new evidences of indebtedness, whether such partial completion occurred before or after the filing of the petition, shall not be construed as limiting or prohibiting the effect of the act, and the

"written consent of the holders of any securities outstanding as the result of any such partial completion

> or execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition."

In the brief of appellant Florence Moore (p. 30) it is urged that Section 82 means simply that the R. F. C. is entitled to enforce the old bonds as collateral to such extent as may be necessary to return the amount of its advance. If that be true, Section 82 adds nothing to the law as that would be clearly the right of any pledgee. Furthermore, if the R. F. C. is entitled to enforce the old bonds it would get ninety cents on every dollar collected by the district until such time as its advance was repaid. This is but another way of saying that the district "cannot pay its debts as they mature" because obviously if the old bonds are to be serviced, default and collapse would be inevitable long before the amount of the advance could be returned.

It is said we contend for a retrospective interpretation of Section 82 but this is premised upon the erroneous assumption that the old bonds were extinguished and cancelled before Section 82 was enacted. The contrary has been shown to be the case.

The same brief passes Section 83(j) with the statement it is limited to cases where refunding bonds have been issued but here appellant misses the plain intent of the statute. If partial completion of a plan and the delivery of refunding bonds under Section 83(j) does not limit the creditor's claim, for a stronger reason it is not limited where the old bonds are still outstanding.

The cases decided under Sections 81 to 84 as to the status of the R. F. C. in these reorganization proceedings

are in full accord with the foregoing statements and are clear, forceful and convincing. See, in addition to *Luehrmann v. Drainage Dist. No. 7* (June 1939, 8th Circuit), 104 Fed. (2d) 696 (certiorari denied November 6, 1939), which is really conclusive, the following:

In re Drainage Dist. No. 7, 25 Fed. Sup. 372;

In re Merced Irr. Dist., 25 Fed. Sup. 981;

In re Lindsay-Strathmore Irr. Dist., 25 Fed. Sup. 988;

In re Corcoran Irr. Dist., 27 Fed. Sup. 322.

D. Aside From the Clear Provisions of the Bankruptcy Act, Principles of Law so Long Established and Adhered to as to be Fundamental, Make the R. F. C. a Creditor for the Full Amount of the Old Bonds Held by it, if as Here, that be the Intention of the Parties.

Prior to the enactment of Chapter IX the question now under consideration has repeatedly arisen in reorganization cases. There is almost always a small minority of dissenters, as here, and reorganization agencies found it necessary to acquire outstanding securities and hold them at their full face value so as to assure equality among all holders. A long line of cases upholds such practice. We refer to but a few of such cases where the parties intend the obligations to remain outstanding:

Barry v. Mo. K. & T. Railway Company, 34 Fed. 829, at p. 832:

"It was competent for the railway company, in carrying out its scheme of refunding, to agree with the holders of income bonds, coupons or certificates that, upon their exchange of their securities for new bonds, those surrendered should not be deemed paid, but should be kept alive to protect them against any enlarged claims of non-assenting holders; and, if such

an agreement was made, the surrendered securities are to be regarded as held in trust by the trust company for the benefit of those who surrendered them. Ordinarily such an agreement or some other arrangement for the protection of those who surrendered securities, having a prior lien for securities secured by a junior mortgage, is one of the features of the refunding schemes of corporations."

The above case (*Barry v. Mo. K. & T. Railway Company*) is based on *Ketchum v. Duncan,* 96 U. S. 659, 24 L. Ed., 868, in which it appeared that Alexander Duncan held coupons due in May and November, 1874, from bonds issued by Mobile & Ohio Railroad. He brought suit to foreclose the lien thereof. Other bondholders also sued to foreclose claiming that the coupons held by Duncan had been cancelled by payment. The court held that the facts showed an intent to purchase the coupons and not to cancel them. It says on page 871 (of Law Ed.):

"Such a sale would have worked no injury to the bond holders of which they could complain. They are in no worse condition now than they would have been in the case supposed."

And concludes, page 873:

"In view of this, it cannot be maintained, either that the coupons of May and November, transferred to Duncan, Sherman & Co., were paid, or that, in obedience to any rule of law or equity, the net earnings of the road should have been applied in payment of them. They are, therefore, existing liabilities of the railroad company, and protected by the first mortgage."

Claflin v. South Carolina Railroad Company, 8 F. 118, was a suit in equity by bondholders of the South Carolina Railroad to foreclose a mortgage subject to the lien of prior encumbrances. Certain bonds had come into the hands of the issuing company and had afterwards been resold. The court says, page 124:

> *"As against other bondholders secured by the same mortgage, I cannot believe there is a doubt of the power of the company to put out and keep out the entire issue up to the time the bonds become due. The contract with the individual bondholder is no more than that he shall have his due proportion of the security the mortgage on its face implies."*

In *Slupsky v. Westinghouse,* 78 Fed. (2d) 13, the court says at page 16:

> "Whether the acquisition of bonds by the corporation which issues them amounts to payment and cancellation, or to a purchase, depends upon the intention of the parties."

In *Burlington City Loan & T. Co. v. Princeton Lighting Co.,* 72 N. J. Eq. 891, 67 Atl. 1019 (Nov. 18, 1907), it is held:

Where an agreement for the merger of corporations provides for the exchange of the whole of an outstanding issue of bonds for new bonds of the consolidated company by depositing them with a trustee, *and the deposited bonds are held by the trustee uncancelled, and the agreement is not consummated owing to the failure of some of the old bondholders to assent,* the question whether the bonds actually deposited are to be held as additional security for the benefit of those depositing them and taking new

bonds in exchange, or for the benefit of all holders of the new bonds, depends on the intention of the parties and the facts of the case. The court says:

> "* * * Three views suggest themselves to us as possible: (1) the deposited bonds may be held for the benefit of all the new Princeton bondholders pending the exchange of the whole issue; (2) they may be held as collateral security to the new bonds taken in exchange and for the benefit of the depositing bondholders only; or (3) *they may be treated as satisfied for the benefit of those who have refused their assent to the scheme. The last seems to us inequitable, for the reason that it allows nonassenting bondholders to profit by a transaction which they have in effect opposed. All that they are equitably entitled to is such a proportion of the mortgage security as their bonds bear to the whole issue. Barry v. M. K. & T. Railway Co.* (C. C.), 34 Fed. 829. This allows them all they would have but for the merger agreement, and merely denies them an increased security due to the efforts of others. *Equity does not allow them to gather the fruit after others have shaken the tree.* While it may fairly be argued as some of the cases suggest that the depositing bondholders by the exchange of bonds evince an intention to give up the lien of their old bonds, it by no means follows that they intend to give up that lien for the benefit of those who refuse to cooperate with them. It is far more reasonable to assume that, if they give it up at all, it is for the benefit of all the new bondholders, who, in return, allow them to share in the security of the new bonds."

In *Mowry v. Farmers' Loan & Trust Co.,* 76 Fed. 38, the court says, page 43 et seq.:

> "* * * The scheme of reorganization here involved is manifested by the agreement between the assenting

bondholders and stockholders and their trustee or committee, and by the concurring act of the railroad company, manifested by the mortgage issued by it to effectuate the scheme. It was clearly expected that all the bondholders under prior mortgages and the stockholders would unite in this plan of reorganization; and yet, *recognizing what oftentimes, and perhaps generally, occurs in the reorganization of railways, that some of the bonds might not be found, or that some holders would not assent to the scheme of reorganization, provision would seem to have been made to guard against just such a contingency, and to prevent the inequitable result which will follow if nonassenting bondholders should, by means of and through the reorganization to which they would not agree, obtain, with respect to the nonassenting bonds, a decided and inequitable advantage over assenting bondholders, who theretofore stood with them upon an equal plane.* * * * The legal effect of the transaction was that the assenting bondholder received the consolidated bond and held the prior bond, keeping both alive until the satisfaction of prior mortgages * * * *as observed by Judge Wallace in Barry v. Railway Co.*, 34 Fed. 829-833, *when it became necessary to enforce the mortgage securing the nonassenting bonds, 'complete equity is done them if they are awarded the same share of the proceeds of the property which they would have received if no bonds had been surrendered'.''*

In *American Brake Shoe & Foundry Co. v. New York Rys. Co.*, 277 Fed. 261 (1921), it was held, following the *Barry* case, that a purchase by a corporation of its own bonds with cash in its treasury does not extinguish the same where it was the manifest intention they should be kept alive. Suit was brought to foreclose the first mort-

gage. There were one million dollars of first mortgage bonds pledged with plaintiff as collateral security for a loan to the railroad company. It appears that these bonds were purchased at an average cost of not exceeding 80% by the debtor and pledged as collateral security for the loan of $1,200,000. Later this loan was reduced to $400,000. Plaintiff did not claim a lien upon the bonds but insisted that they are still outstanding. Other defendants claimed they were extinguished. Court held it was the clear intention of the railway company to keep the bonds alive. The court says (p. 281):

> "Such a course is both lawful and proper. It is always a question of intention."

At page 282 the court says:

> "There are bonds thus outstanding to the extent of $18,019,948.24. But a bond cannot be outstanding and yet not outstanding. It is either dead or alive. If alive, it is entitled to share in the proceeds of the foreclosure sale. The situation merely is that plaintiff owns seventeen-eighteenths, in round numbers, and Railways Company owns one-eighteenth, in round numbers, subject to the $400,000 pledge. All the mortgaged property is security for the whole eighteen-eighteenths. Hence plaintiff will be entitled to seventeen-eighteenths and Railways Company (which, in the circumstances, means its creditors) to one-eighteenth, in round numbers, of such sum produced by foreclosure sale, as ultimately may be held to be applicable to the payment of the mortgage debt.
>
> After, therefore, the $400,000 shall have been paid, the proportionate balance, if any, will go to the Railways Company, and will be applicable to the payment of general creditors' claims as between this plaintiff and defendant Railways Company."

In *Missouri K. & T. R. Co. v. Union Trust Co.,* 156 N. Y. 592, 51 N. E. 309 (1898), we find the following pertinent language at page 599:

> "* * * In other words, as held in *Barry v. M. K. & T. Ry. Co.* (34 Fed. Rep. 829), purchased bonds must, for many purposes, and in this case for the purpose of the sinking fund clause, be considered as still unpaid, so far as the rights of the outstanding bondholders are concerned."

In *Fidelity & Columbia Trust Co. v. Louisville Ry. Co.,* 258 Ky. 817, 81 S. W. (2d) 896 (1935), it was held:

> Purchase of its bonds by railroad from trust company before maturity as extended and pledge of them as security for payment of purchase price pursuant to refinancing plan expressly providing that railroad may after payment of purchase price reissue such bonds from time to time to provide necessary funds would not constitute an extinguishment of such bonds.

The refinancing plan provided that the railroad would purchase its first mortgage bonds and that it would pay for them by executing a note and pledging the bonds to secure the payment of the purchase money notes. The court says, at page 899:

> "The rule recognized without exception by American courts is that a corporation may purchase its own bonds and reissue them where there is a manifest intention to keep them alive. In other words, the purchase by a corporation of its own bonds under such conditions does not operate as an extinguishment of the debt. The English rule was contrary to the American rule until changed by an act of Parliament in 1907."

The court then quotes approvingly from the *Barry* case and follows with citations of the *American Brake Shoe and Foundry Co.* case, *Claflin* case, *Westinghouse Electric Manufacturing Co.* case and a number of others and concludes as follows:

> "The text-writers, basing their text on these cases, have uniformly stated the rule to be that the purchase by a corporation of its own bonds before maturity with a plainly evidenced intention to keep them alive and reissue them does not operate as an extinguishment of such bonds. Thompson on Corporations (3d Ed.) Vol. 3, Sec. 2401, p. 1105; Cook on Corporations (6th Ed.) Vol. 3, Sec. 762, p. 2579; Fletcher on Corporations, Revised Edition, (Vol. 6) Sec. 2729, p. 589; Jones on Corporate Bonds and Mortgages, Sec. 325; 14 A Corpus Juris, pp. 644 and 648. We conclude that the purchase by the Louisville Railway Company of its first mortgage bonds under the proposed refinancing plan, after the maturity of the bonds has been extended, will not extinguish the bonds."

In *John Wanamaker New York, Inc. v. Comfort, et al.*, 53 Fed. (2d) 751 (1931), the court says at pages 753-754:

> "* * * Another case very much in point is Mowry v. Farmers' Loan & Trust Co. (C. C. A.) 76 F. 38. In that case it appeared that the reorganization agreement of a railroad provided for the issuance and exchange of new securities for old, the deposited bonds to be held by the trustee under the mortgage as additional security for the new bonds. It was held that the bonds deposited were not extinguished and the lien securing them was not waived. To the same effect are the cases of Barry v. Mo. K. & T. Co. (C. C.) 34 F. 829; N. Y. Security & Trust Co. v. Louisville, E. & St. L. Consol. R. Co. (C. C.) 102 F. 382; and the

U. S. v. Grover (D. C.) 227 F. 181, in all of which it was held that the intention of the parties must govern and that new issues of bonds were valid and protected by the lien of the original mortgage."

Appellants have nothing to say about the long line of authorities just cited,[9] except that in the brief of appellant Florence Moore (p. 31) the case of *Barry v. Mo. etc. R. Co.*, 34 Fed. 829, is referred to lightly with the statement that—"there is some authority (although it is not generally accepted)." The truth is that *Barry v. Mo. etc. R. Co.*, is a leading case cited with approval in practically all of the cases just listed, right up to and including the very recent decisions there noted. Furthermore, the rule expressed in that case is said in *Fidelity & Trust Co. v. Louisville etc. R. Co.*, 258 Ky. 817, 81 S. W. (2d) 896 (1935) *supra*, to be the uniform rule approved by the text writers.

And finally: what the *Barry* case held in effect was *that dissenting security holders are not entitled to any more than they would have received if consenting security holders had not surrendered securities pursuant to a plan of reorganization. In other words, the dissenting bondholders here are required to establish their rights on the basis of a $16,000,000 bond issue.*

E. Further Answer to Appellants' Contentions Herein.

1. Appellants say if there was a "loan" the old bonds must be held as a "pledge" or "collateral security" and can only be enforced up to the amount expended by the R. F. C.

9. Nor do they attempt to meet the holding in *Luehrmann v. Drainage Dist. No. 7*, 104 F.(2d) 696 (certiorari denied Nov. 6, 1939), which is directly in point on the status of the R. F. C.

And they say that the resolution of November 14, 1934 (Ex. OO, 165), provides that if the district should, before delivery of the new bonds, repay the R. F. C. the amount expended, the obligation would be terminated. Hence they argue, the district owes only $7,570,871.60 to the R. F. C. From this they conclude that the R. F. C. is a creditor only to the extent of $7,570,871.60 and that the district can pay its debts as they mature.

There are many answers to this, namely: (a) The authorities cited in paragraph *D* above are to the contrary, (b) the contract relating to the purchase of the old bonds is the agreement of August 14, 1935 (Ex. OO, 217), and not the resolution above referred to, (c) the claim assumes that the R. F. C. holds the demand note of the district for the money used to purchase the old bonds, to-wit $7,570,871.60, and that it holds the old bonds as security for this demand note. Of course no note was given by the district and it did not agree to repay this money, (d) but in any view the district is unable to "pay its debts as they mature". It does not have $7,570,871.60; could not raise such a sum of money in cash over a period of years; obviously could not sell refunding bonds for that sum of money with dissenters' bonds outstanding, and any attempt to enforce payment of that much money in cash or to enforce the old bonds alleged to be held as security up to the amount of such demand would unquestionably result in default and collapse.

2. Appellants seem to argue that the R. F. C. could be forced to accept refunding bonds to the extent of its alleged advance. Not a syllable in the contracts justifies

such claim. It is of course quite a different thing to accept refunding bonds when all of the old bonds have been turned in and to accept refunding bonds when there are approximately two million dollars outstanding on a former issue. No sane banker or underwriter would accept refunding bonds on such basis.

3. The fact that the district paid with its own funds certain money to the consenting bondholders at the time they sold to the R. F. C. proves nothing. The purchase of the bonds by the R. F. C. was admittedly in the interest of the district. It was a step in refinancing and afforded sufficient consideration for the district to expend money in aid thereof.

4. The setting up of the reserve funds and the power allocation is merely a step in the carrying out of the agreement for the purchase of refunding bonds pursuant to the agreement of September 16, 1935 (Ex. OO, 202). If refinancing is never consummated and the R. F. C. does not take the refunding bonds obviously the set up of the reserve funds and the allocation of the power is nullified.

It is argued that the R. F. C. is in a different class of creditors because of the allocation of power revenue and that therefore it is the holder of a claim for the payment of which specific property or revenues are pledged; that accordingly under 83b it constitutes a separate class. If this were true and its preference was disregarded in classifying creditors it is a point of which the R. F. C. alone may take advantage. It is not error to the injury of appellants.

5. It is claimed, that the R. F. C. did not file a claim or allege ownership. The petition alleges that the R. F. C.

is the owner of the bonds and, as such owner, consented to the plan of composition attached to the petition (R. 17, 32). The evidence proved the allegations and the court so found. Under these circumstances, it is far-fetched to argue that the proceeding must fail because no alleged claim is on file. Of course, the record is replete with the claim of the R. F. C. (see Ex. 16, R. 644, acceptance of the plan) and furthermore, the act itself expressly provides (Sec. 83d) that creditors whose claims are "admitted by the petitioner or allowed by the Judge" are to be counted in making up the required percentage of creditors.

6. The pledge argument has been answered.

7. It is claimed that neither the R. F. C. nor the district had authority other than to make a loan. This is wrong on all counts. (a) The R. F. C. is authorized to consummate a loan through the purchase of securities (Sec. 36, Emergency Farm Mortgage Act, Title 43, Sec. 403, U. S. C.); (b) the district is authorized to make contracts with the R. F. C. relating to refinancing (Cal. Stats. 1935, Chap. 615, Secs. 1 and 11) and this of course includes necessary and incidental power to make the refinancing effectual; (c) if the contract of either agency were *ultra vires* this is an objection appellants cannot raise.

Union Nat. Bank v. Matthews, 98 U. S. 621, 25 L. Ed. 188, 190;

McCann v. Childrens Home, 176 Cal. 359, 364.

The Supreme Court has recently reasserted the rule that a private individual may not invoke judicial power to determine the validity of executive or legislative action

unless he sustains direct injury not common to the public. See,

Ex Parte Levitt, 302 U. S. 633, 58 S. Ct. 1, 82 L. Ed. 493 (Appt. Justice Black);

Alabama Power Co. v. Ickes, 302 U. S. 464, 58 S. Ct. 300, 82 L. Ed. 374 (Jan. 3, 1938—PWA grants).

Appellants were not injured by the R. F. C. purchase. Anyone could have purchased. In truth, by any test, appellants were benefited. Furthermore, it would not follow if the parties acted without authority of law that the court would make a new and different contract for them. If the action was void it might follow that the old bondholders would have some remedies but not that the transaction would be converted into something not intended by the parties.

8. It is argued that no statute permits debts that have been extinguished to be treated as still existing. This has been answered. They are *not* extinguished.

9. It is claimed that the plan has been fully executed out of court. This, too, has been answered. *In re West Palm Beach,* 96 Fed. (2d) 85, there was a completed plan of reorganization, cancellation of the old bonds, and delivery of the refunding bonds. Furthermore, subsection (j) of Section 83 of the Bankruptcy Act was undoubtedly added to change the rule in the *West Palm Beach* case.

10. It is argued that the R. F. C. and the district are bound by the acceptance by the R. F. C. of the plan in the state court under California Stats. 1937, Chap. 24, Sec. 19. The exact point appellants make is not clear but in any event Section 19 clearly is not applicable because

the proceeding in the state court was not dismissed nor was there a declaration of invalidity. Section 19 by its terms is only applicable if the action is dismissed because the plan is found to be unfair or if the act is otherwise found to be invalid. Its purpose is merely to protect against the release of consenting creditors in such contingencies. It has no bearing here.

ANSWER TO SECOND PROPOSITION: "PETITIONER IS BARRED * * * BY REASON OF ITS LACK OF GOOD FAITH AND CONSTRUCTIVE FRAUD."

1. The District's Hands are Clean.

It would be interesting to debate with appellants whether if the district in truth had "unclean hands" it would be barred from relief regardless of the merits of the plan, the interests of creditors and public repose. "Good faith" is probably used in the Bankruptcy Act in the sense of "feasibility" and ability to carry out (see, *Tenn. Pub. Co. v. American Nat. Bank,* 299 U. S. 18, 57 S. Ct. 85, 81 L. Ed. 13, at 15). Reorganizations where necessary are in the interest of the creditors as well as the debtor (see *Chicago Title & T. Co. v. Forty One Thirty Six Wilcox Bld. Corp.,* 302 U. S. 120, 58 S. Ct. 125, 82 L. Ed. 147, per Justice Cardozo, dissenting opinion, p. 154; *Compare Getz v. Edinburg etc. School iDst.,* 101 Fed. (2d) 734; *Radio-Keith-Orpheum Corporation,* 106 Fed. (2d) 22). Sec-83e provides that the plan must be confirmed if certain things are shown and "clean hands" are not one of them.

But we pass this question because the record is clear to the point of demonstration, that the District at all

times has acted with the utmost fairness and good faith. The assertion to the contrary is not only wholly unsupported by any meritorious evidence but is based on the flimsiest of technical reasoning by those to whom the utmost courtesy and cooperation have been shown in respect to all records and information in the custody of the district. They have had the benefit of the services of district employees in the preparation of exhibits, and all of the investigations, studies by engineers and other experts, and legal and other expenses of the Bondholders' Committee were paid by the district (R. 371-372), including the cost of the Benedict report (Ex. 35).

The charge now made by appellants was really for the first time made in affidavits upon motion for new trial which the court denied "in toto" after "re-examination of the entire record" (R. 267) including the affidavits. Petitioner's affidavits, which furnish a complete answer, are found in R. 254-265. Note particularly on the charge of bad faith, the affidavit of H. P. Sargent, secretary of the district (R. 257-261). On this point, note also as merely illustrative, Exhibit 37 (R. 736-754, letter from bondholders' committee to bondholders, dated December 15, 1933, and signed by a number of the appellants here) which shows that the committee was advised of the financial status of the district to the minutest detail.

The district's books and record of accounts were continuously in the public eye from 1931 to date being used by bondholders and their representatives, by various mortgagors and property owners who had investments in the district, by officials of the California Districts Securities Commission, a public agency which from time to

time made detailed investigations and reports on the district (Exs. 29-33A, R. 678-732) and through the medium of financial statements publicly rendered by the district from time to time (see Ex. X, R. 827 et seq.—annual statements of district 1931-1937 inclusive).

There was no fraud or misrepresentation.

2. Petitioner Did Not Divert $717,932.50 of Trust Funds.

Appellants would have it appear that the district in effect "embezzled" money belonging to bondholders. The fact is, that all money taken in by the district has been meticulously accounted for, and if there is any money which went into the general fund which should have gone into the bond fund it is now in the treasury of the district and applicable to the satisfaction of the bondholders' claims in the event that the plan of composition fails. What appellants are really objecting to is simply a matter of bookkeeping, that is to say, whether certain money should have gone into the bond fund instead of the general fund. If, however, it was bond fund money, *that and a great deal more than the amount alleged to have been diverted, is in the district treasury for the satisfaction of any bondholders' legal right.*

It is not charged that the district in the years following the default spent any more than was necessary for operation and maintenance of the district. It is not charged that it was extravagant. On the contrary the evidence established that betterments and very necessary improvements have been deferred (R. 513). Any property acquired by the district, as pointed out in *Provident Land Corp. v. Zumwalt,* 12 Cal. (2d) 365 at 376 (85 P. (2d) 116),

is held in trust for all the purposes of the act, including operation and maintenance.

The district has not spent one unnecessary cent and what it did spend in operating and maintaining the district was in the interest of bondholders. Furthermore, every dollar collected either by way of assessment or power revenue or on delinquencies or sale of land and not expended for operation is now in the treasury to be put in whatever fund the court deems proper and disbursed as required by law if the plan of composition fails.

The $717,932.50 is really $320,272.93 (R. 413-414). Each year from 1922-23 to 1931-32 inclusive, after bond service was satisfied, the balances of the bond fund levy (delinquency collections, etc.) were placed in the general fund as expressly authorized by law (Sec. 67a, Irrigation District Act, in effect when bonds were issued (Cal. Stats. 1917, p. 769), reading as follows:

> "Whenever an object for which money has been specifically provided by assessment or by bond issue has been accomplished and any money provided therefor remains unexpended, the same shall in the discretion of the board of directors be transferred to the general fund and thereafter be available for any of the purposes of this act."

This accounts for all except $320,272.93.

The $320,272.93 represents collections of delinquencies from time to time on the 1932-33 tax levy after 1933 and up to the present. The levy was to service bond obligations due January 1, 1933 and July 1, 1933. The assessment went 62% delinquent (R. 402) and there have been no levies for bond service since (R. 403). The district

has met all obligations due to July 1, 1933 (R. 400-404) so in considering the $320,272.93 we are only concerned with the bond obligations due July 1, 1933.

Note the following: (a) The first refunding plan which the bondholders' committee (made up in part of appellants) and the district tentatively approved and endeavored to carry out, and which, from the standpoint of good faith is important, expressly provided that "no payment is to be made upon the coupons which were due July 1, 1933 and that the payment of the bonds and coupons which were due January 1, 1933 is to constitute in effect full payment of interest falling due during the entire year" (R. 748). (b) The plan submitted in the first bankruptcy action, and under which the district operated from April 1935 until reversal by this court in April 1937 (R. 518) contemplated no payment due on the July 1, 1933 coupons. $515.01 was, and is, a flat amount for the bond, including all coupons due July 1, 1933 and subsequently. After the Supreme Court denied mandate in the first bankruptcy case in October 1937 (R. 519), the district filed in the state court; the same plan was involved there and Section 5 (Cal. Stats. 1937, Chap. 24) again put the plan temporarily into effect until this present proceeding was filed in June, 1938 (R. 519). Hence during the period in question the action of the district in placing delinquency collections on the 1932-33 levy in the bond fund has had the express or implied sanction of the bondholders' committee or the court (Ex. 16, R. 644) and the district has operated under the jurisdiction of the Districts Securities Commission.

So it all comes to this: $320,272.93 which was collected on delinquencies on the 1932-33 levy during the years succeeding 1933, was put in the general fund. It has been replaced many times over by general fund money now in the treasury and no unnecessary expenditures have been made. All of the January 1, 1933, coupons have been paid. If the plan is confirmed by the court appellants receive $515.01 in lieu of each $1000.00 bond, including the coupons due January 1, 1933, and subsequently. If the plan is not approved and the district reverts to the old bond issue, $320,272.93 is available in the district treasury for transfer to the bond fund where it can be used to service the coupons due July 1, 1933. Money has not been diverted in the sense that it has been lost to the bondholders if they can prove any right to it.

And finally, if the district reverts to the old bond issue the R. F. C. obviously holds roughly 91% of the coupons due July 1, 1933, and it also holds most of the matured bonds (App's. Brief p. 60), so that at most all of appellants taken together would be lucky to establish a claim to $32,000 of the money and probably not that much since the R. F. C., in general, holds the coupons having the first priority.

3. Petitioner Has Not Defrauded its Creditors.

It is charged that the alleged diversion of bond funds had the "necessary effect" of "driving down" the market price of the bonds and thereby stampeding bondholders into accepting the plan now sought to be enforced. (Brief p. 45).

A more distorted statement would be difficult to imagine. The granting of the R. F. C. loan in November, 1934 *raised* the price of bonds from eighteen cents to approximately fifty cents on the dollar (R. 500). The alleged collections were for the most part long after that date.

The alleged refusal to levy taxes for bond service during 1933-34-35-36-37-38 was not a refusal at all, but pursuant to law (Sec. 11 of the Districts Securities Commission Act, Cal. Stats. 1933, Chap. 60, 1935, Chap. 36 and 1937, p. 491). The levies were all duly approved by a state agency (Exs. 29-33A, R. 678-732). No attempt has been made by the bondholders to challenge the legality, constitutionality or equity of that law.

It is said (Appellants' Brief p. 46) that the district gets cheap water, and an attempt is made to compare this with other districts. Comparison of cost per acre feet of water in various irrigation districts is absolutely impossible with any degree of accuracy; each district has its individual problem of water distribution which affects cost; the duty of water in various irrigation districts differs; canal losses from diversion point, policy as to point of delivery, and type of service, are a few of the factors which make it impossible to have any degree of accuracy in comparison of cost of water delivered to the land. A further obvious unfairness in the comparison of water cost is that the cost in the Merced District under the emergency tax rate under Section 11, is compared with costs to lands in Banta-Carbona, Lindsay-Strathmore and Turlock Districts for the year 1929, not under Section 11 but under regular operation and maintenance and bond service assessments.

Appellants' statement of testimony on tax delinquencies (Brief pp. 46-47) entirely omits to notice the fact that from the tax rolls in each of the years noted, particularly 1936, there was deducted a large amount of delinquent taxes through the district's taking deed to the property (Ex. 28, R. 677). The average delinquency for the three years as of November 1, 1938, therefore, should be 7.5% not 1 1/13% (Ex. 25, R. 668).

4. The District Did Not Misrepresent its Financial Condition.

In support of their claim that the district misrepresented its financial condition, appellants offer mere fragments of the testimony giving it a garbled effect. The exhibits of Mr. Neel, the district controller, taken together with the financial statements (Exs. 23, 24, 25, 26, 27, 28, R. 662-678) present not only a clear picture of the district's financial status but answer every pertinent question anyone interested in the district would care to ask. They are really a very beautiful presentation from an accounting point of view, and we respectfully ask the court to examine them as a whole.

These exhibits were prepared in advance of trial and submitted to counsel at the start of the case so as to enable them to prepare for cross-examination or to ask for additional data. Furthermore, Mr. Neel prepared other exhibits for them at their request and worked with them, both in and out of court, so that a complete and accurate picture of the district's finances could be presented to the court.

A very unfair attempt is now being made to distort Mr. Neel's testimony and exhibits. A specific examina-

tion of these points will show that they relate not to substantial or meritorious matters but to purely technical matters relating to bookkeeping not in any sense connected with the merits of the case. In essence, appellants are asking that the plan be rejected because they say they do not agree with Mr. Neel on questions of bookkeeping concerning which doctors of accounting (C. P. A.'s) are at issue (R. 254—affidavit of Charles A. Lumbard, C. P. A.).

A. Petitioner Did Not Overstate its Liabilities.

The $824,684 paid as interest to the R. F. C. was carried by Mr. Neel on his books as an interest expense account (R. 425), in the nature of a refinancing charge. Of course if the plan fails it should probably be credited against the interest due on the old bonds held by the R. F. C. and Mr. Neel properly showed it as such a credit when he cast up the district tax rate in the event that the old bonds were serviced (R. 401, Ex. 22, R. 661). The fact of such interest payments appears over and over again in the evidence (R. 369, 425, Ex. E, R. 764). So there was no concealment or distortion of the account—merely a dispute as to bookkeeping entry.

$168,582 paid as interest to depositing bondholders was properly charged as a refinancing expense by Mr. Neel (R. 368, 369, 763, 865). There was of course no concealment whatever as to the payment itself (R. 763-764).

The $129,100 item (interest accruing on registered coupons and bonds) should be credited on the bonds if the $824,684 is credited, and not otherwise. It therefore falls in the $824,684 item, *supra.*

Exhibit 26 is said to overstate the bond principal liability by $387,000; in other words, the district is said to represent it had a total principal liability of $16,578,000 notwithstanding the fact that the record *from the filing of the petition constantly* to the end of the case shows that the amount of principal bond liability was conceded by everybody to be $16,190,000 (R. 10). Furthermore, reference to the affidavit of Charles Lumbard, C. P. A. specializing in governmental accounting (R. 254-256) will show that the $387,000 was an internal item and correctly set up in Exhibit 26 (see also R. 520). Mr. Lumbard was the referee appointed by the court in *Morris v. Gibson,* 96 Cal. App. Dec. 347, 87 Pac. (2d) 37, 41, and his report was the basis of the decision in that case.

B. Petitioner Did Not Understate its Assets.

Very properly Exhibit 26 (speaking as of November 1, 1938) did not include as an asset the assessment levy of approximately $340,000 made for the year 1938-39. If so, it would have been proper to include the estimated expenditures for 1939 against the assessment (See affidavits of Mr. Neel and Mr. Sargent, (R. 257 to 265)). The facts relating to this assessment levy, as in all other questioned items, were clearly in the record.

Whether the amounts expended to purchase Crocker-Huffman water rights, to-wit, approximately $840,000 should appear as an asset is a question. Bookkeepers will differ as to whether such expenditures should be capitalized or are to be considered as a tax equalization between taxpayers under the old Crocker-Huffman system and new

lands included in the district and therefore an operating charge. The facts are all in the record (R. 511).

C and *D* have already been answered in *A* and *B*. We might again point out, however, as shown at p. 59 et seq. of this brief, excess of assets over liabilities does not prove ability to pay. Conceding everything argued here to appellants and a surplus of assets over liabilities, nothing is established on ability to pay.

Appellants charge (Brief p. 55) that petitioner maintained books and records on two separate theories of its liabilities to the R. F. C. This is not true. The district has consistently carried the old bond issue as a liability (Ex. 26, R. 669; Ex. I., R. 766). The R. F. C. submitted certain form reports for the district to fill in (Ex. J, R. 774, and Ex. K, R. 784). These forms do not purport to show the assets and liabilities of the district as reflected by the district books. The form expressly provided "Do not include outstanding bonds of issues to be refinanced" (R. 778, 788).

Appellants say (Brief p. 55) that "The existence of these reports and balance sheets was discovered by appellant's counsel on an inspection of petitioner's records just prior to trial under court order" (R. 143). The district voluntarily stipulated that the district's files could be inspected (R. 143). There was no coercion. If they were not inspected long before it was counsel's own negligence in not asking for it.

This case substantially had been tried twice before—once before Judge Cosgrove in the Federal court at Fresno and again before the Superior court at Merced. Before and during those trials appellants were given

whatever information they asked for on every occasion including all the records of the district that they wished to inspect. There is not even an intimation in the record of this trial that appellants were not given full access to the district's records at all times during the former trials and it is a fact that the district staff has been kept busy serving their demands. The present contention is pure after-thought conceived since the third trial and wholly unfounded on reality.

ANSWER TO THIRD PROPOSITION: "PETITIONER HEREIN IS NOT 'INSOLVENT OR UNABLE TO MEET ITS DEBTS AS THEY MATURE.' "

Appellants assume hereunder that the old bonds purchased by the R. F. C. are no longer liabilities.

So long as the old bonds are outstanding and enforceable according to their tenor the district cannot possibly "pay its debts as they mature" and appellants make no serious effort to show the contrary.

But it is argued that if the old bonds held by the R. F. C. are no longer obligations, the liabilities of the district are limited to the bonds of the dissenters and the amount paid by the R. F. C. for the old bonds. Even that would not prove that the district could pay its debts as they mature.

According to appellants the district owes the R. F. C. "only" $7,570,871.60. Assuming the truth of that how is it to pay $7,570,871.60 to the R. F. C.? It cannot require the R. F. C. to accept refunding bonds for that amount and it cannot require the R. F. C. to postpone indefinitely the repayment of this huge sum of money. Pre-

sumably, if appellants' theory is correct, the R. F. C. at any time can demand payment of the entire sum and if the district defaulted, which of course it would have to do, no attempt to levy or collect assessments for the payment of this huge sum would be helpful. On any theory, the district is unable to "pay its debts as they mature."

ANSWER TO FOURTH PROPOSITION: "THE PLAN OF COMPOSITION IS NOT FAIR, EQUITABLE OR FOR THE BEST INTERESTS OF THE CREDITORS AND IT IS DISCRIMINATORY."

Luehrmann v. Drainage Dist. No. 7, 104 Fed. (2d) 696:

On November 6, 1939, the Supreme Court denied certiorari in the above captioned case and the decision is now final (denied under name of *Haverstick v. Drainage Dist. No. 7*—citation not yet available). A reading of the opinion (a composition proceeding under Chapter IX) will show that practically every issue before the court in this case is passed on favorably to petitioner, including the insolvency of the district, the fairness of the plan, and the status of the R. F. C. It is direct authority for the district with respect to all of these issues and many collateral points raised by appellants. We shall not review the case in detail but respectfully ask the court to read it in full as it will conclusively eliminate most of appellants' contentions not only on the Fourth Proposition but many others.

It is highly significant that certiorari in the *Luehrmann* case was denied the same day the court decided *Case v. Los Angeles Lumber Products Company, Ltd.*, next to be reviewed. Probably the denial of certiorari is a sufficient ruling that an offer of "composition" of the debts of a

public agency is not to be judged with respect to the fairness of the plan by the same principles which control reorganizations of corporations under Sec. 77(b). Nevertheless, because of the danger of misconstruing the effect of the decision in *Case v. Los Angeles Lumber Products Company, Ltd.,* we shall devote some space to its review and shall show that even if petitioner is required to meet the standards of that case it has done so by every test.

Case v. Los Angeles Lumber Products Company, Ltd., ... L. ed. (Adv. Op.) .....*

This case seems to hold (a) that consent of creditors exceeding the statutory requirements is not evidence the plan is "fair or equitable" in a reorganization proceeding under 77B and (b) as a matter of law the plan is not "fair or equitable" if stockholders in an insolvent corporation having liabilities in excess of its assets are allowed to participate before the full value of the property is first applied to the claims of bondholders.

The case seems to recognize that "composition" may be different from "reorganization." It is said in the foot note 14:

> "The statutory scheme of Sec. 77B (in those respects which are material here) is in sharp contrast to that which was provided for compositions under former Sec. 12. This court said in Callaghan v. Reconstruction Finance Corp., 297 U. S. 464, 470: 'Reorganizations now permitted under Sec. 77B present certain resemblances to compositions under Sec. 12, which have been commented upon as supporting the constitutionality of the reorganization provisions of Sec. 77 or Sec. 77B. * * * But Sec. 77B contemplates

*Citation not yet available.

> a procedure and results not permissible under Sec. 12. Reorganizations are nowhere referred to in the statute as compositions.' Under Sec. 12(a) (as it existed at the time Sec. 77B was enacted) only a 'bankrupt' could offer 'terms of composition to his creditors.' "

"Composition" is a method of adjusting rights among those jointly interested in a common right against the debtor. It is an "agreement" which results, "in the main" from "voluntary acceptance" by creditors (*Louisville Joint Stock Land Bank v. Radford,* 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 at 1602). Obviously its essential feature is the "scale down of the debtor's debts."

If there is a distinction between "reorganization" and "composition" the *Los Angeles Lumber Products Company* case is not in point here because Chapter IX unquestionably provides for "composition" not "reorganization." The word "reorganization" does not appear in the chapter. To the contrary, throughout it provides for "composition." Indeed that is one express point of difference between Chapter IX and the law held invalid in the *Ashton* case, 298 U. S. 513; 56 S. Ct. 892; 80 L. Ed. 1309, and Chief Justice Hughes in the opinion in the *Bekins* case, 304 U. S. 27; 58 S. Ct. 811; 82 L. Ed. 1137, emphasizes the "composition" feature and in contrast, says the law stricken down in the *Ashton* case was one for "readjustment of debts." And finally, in the *Bekins* case the complaint was held to state a case. It alleged that the district had offered a plan of composition which provided for the payment to its bondholders of cash equal to 59.988 cents for each dollar of principal

due—in other words a scale down. Similarly, in *Luehrmann v. Drainage Dist. No. 7,* 104 Fed. (2d) 696, *supra,* bonds were, by the plan of composition, scaled down to 25.879 cents on the dollar.

The *Los Angeles Lumber Products Company* case seems to give no effect to the "consents" filed by creditors except as they evidence compliance with the statute. In a composition proceeding where, as we have seen, consents evidence "agreements" "in the main" between those interested in a common right, it would appear some weight might properly be accorded on the issue of fairness where the consents, in the language of the trial court here, "exceed the statutory requirements by nearly 25%."

In the *Luehrmann* case, *supra,* the overwhelming consent of the bondholders to a scale down plus appreciation in the value of the bonds was regarded as sufficient to uphold a finding that the plan is "fair and equitable", the court saying at page 703:

> "* * * The amount of 25.879 cents on the dollar to be paid on outstanding indebtedness is found, and appears to be, fair and equitable, and 'all that could reasonably be expected under all the existing circumstances.' It appears that some of these bonds had theretofore sold for as little as five cents on the dollar. An overwhelming statutory majority of creditors of all classes have accepted the plan, and, in our judgment, the decree of the district court approving it was right and should be affirmed."

By its denial of certiorari in that case the same day the *Los Angeles Lumber Products Company* case was decided, the Supreme court must have had in mind that a

composition plan would be upheld as fair and equitable where the "scale down" of the bonds was approved overwhelmingly by the creditors and the offer had increased the value of their bonds.

A composition proceeding where there is no more than the statutory consent (66%) is one thing. It becomes quite different as the percentage of consent increases. In a composition proceeding it would seem the evidence of fairness should be stronger where 99.5% of the creditors consent than in one where there is a bare 66%.

There are other obvious distinctions between "reorganization" of a corporation and "composition" of the debts of a public agency not only in the vital public interest attaching to the latter but also because of the essential and fundamental differences between a corporation and a public agency. In the former there may be foreclosure, sale, liquidation and distribution of the corporate property, but not in the latter. Furthermore, Section 83 provides that the plan shall be confirmed if the court is satisfied, among other things, that it is "fair, equitable and *for the best interests of the creditors.*" The phrase "best interest of creditors" does not appear in Section 77B. Undoubtedly under Section 83 if the plan is "for the best interests of the creditors" as in the *Luehrmann* case and as here that is a factor in determining whether it is fair and equitable. The record in the instant case is replete with evidence that the plan is for the best interests of creditors.

But it is not necessary to argue in greater detail the manifest differences between Section 77B and Chapter IX based on composition because the plan in this case

was fair and equitable even according to the standards of the *Los Angeles Lumber Products Company* case and entirely irrespective of the consent feature and the benefit to bondholders.

The Plan is Fair.

First: All bondholders were treated exactly alike and all were on a parity. Between them there was no preference or priority. (See Answer to Proposition Fifth pp. 74 et seq. this brief that there were no preferences between them.) The offer is a uniform percentage of the claim as in the *Bekins* case.

Second: To determine whether the plan of a public agency is fair the fundamental question must be what can the debtor pay—what is the maximum bearable debt load of the district? It avails the bondholder nothing if that load is exceeded. As Chief Justice Hughes points out in the *Bekins* case (82 L. Ed. at p. 1145). When landowners cannot pay assessments adequate to service their obligations, the power of taxation is "useless". Under such circumstances Mr. Justice Cardozo says in the *Ashton* case (80 L. Ed. p. 1316), the command to tax is "merely futility" (see R. 409).

You can't bring men to land without water and you can't water the land and make it produce unless someone can operate it successfully and pay off the debt. In order to meet a bonded debt, the farmer must not only be brought to the land but kept there under conditions where he can pay the indebtedness. Unless the man on the land is able to pay his assessment, it is not paid. It is pyramided the next year; if it is not paid in that year

it is pyramided in the following year; until finally it gets to the point where the burden is so heavy that nobody can pay it and it results in a complete breakdown. From the standpoint of the bondholder as well as the landowner, that is one thing which must be avoided.[10]

Also in determining the maximum debt, account must be taken of revenue that is required by the district for operation and maintenance over and above the amount required to service the bonds. Once the district ceases to have adequate funds for operation and maintenance canals become clogged, water rights are lost and eventually the lands revert to their desert character.

What is the maximum debt load the Merced Irrigation District can carry with some assurance of safety? It requires approximately $500,000.00 a year for operation, maintenance and capital betterments (R. 513). Roughly, this will take a sum equal to all the net power revenue and a little more, even on appellants' estimate (R. 527).[11] Cash reserves obviously are necessary against agricultural depressions, droughts, flood years, etc. What can the lands pay for bond service in addition?

Considering that perfection is impossible and that many intangibles are involved whose exact weight is not determinable with mathematical accuracy it is submitted that the offer of the R. F. C. is the limit and more than the

10. In Acquisition and Improvement District No. 36 in San Diego County, the Board of Supervisors this year levied as high as $283,247.54 per $100 of assessed valuation—the result of pyramiding delinquencies. A $10,000.00 investment on that basis would entitle one to a tax bill for the fiscal year 1939-40 of some $28,000,000.00. The process of pyramiding delinquencies is described in *Provident Land Corporation v. Zumwalt*, 12 Cal. (2d) 365 at 370, et seq., 85 P. (2d) 116, and in preamble of California Irrigation District Act, Stats. 1937, Chap. 24, quoted in part in Appendix B herein.

11. The district's estimate based on actual experience was that the net yield would be less than $400,000 annually (R. 407, 408).

limit of considered and conservative judgment. Some leeway too, must be allowed the trier of facts on the exact quantum the district can pay. There is no yardstick that can measure the ability to pay with certainty and as said in *Getz v. Edinburgh Cons. Ind. School Dist.,* 101 Fed. (2d) 734, these cases necessarily present practical problems (p. 736).

The R. F. C. concluded the district could not carry a greater loan than the plan provides for. Remember too, that that is on a basis of 4% interest. The principal load would have to be less if the cost of money were greater and it undoubtedly would be a higher interest rate if some agency other than a relief agency of the Federal Government were the banker. However, there was no evidence of any other offer to refund the bonded debt, except the R. F. C. offer.

For that reason alone the plan is fair and it is more than fair to the bondholders based on the testimony and very able economic study and report of Dr. Benedict on the taxpaying ability of the district (Ex. 35). This was brought up to date by the testimony of the witness Momberg showing that even today the lands are not operating at a profit. The testimony of Dr. Benedict and his report (Ex. 35) has been reviewed at pages 4 to 6, *supra,* and will not further be reviewed here except to say that it is conclusive that the lands of the district cannot carry a tax rate in excess of what the present plan will require—perhaps not that much over a period of years but that is the risk of R. F. C.

The Benedict report comes from the highest source—the University of California. It was disinterested, im-

partial, in the public interest and designed to solve a crying public problem. It was made in cooperation with both bondholders and the district and answers every objection made by appellants on fairness. The statement of the case herein points out much other evidence which is relevant on the issue of fairness.[12] We respectfully direct attention to this—particularly pages 7-19, *supra,* without repeating it and submit that fairness is clearly established.

The court found: (a) that it was the R. F. C. transaction which saved the district from financial ruin and appreciated the value of its bonds from 18 cents to more than 50 cents on the dollar and that without the plan they would be worth much less; (b) that when default occurred in 1933 the lands of the district could not even pay the costs of operation, delinquencies having reached 62% in an effort to service the bonds; (c) the productivity of the land and its revenue are now little, if any, better than they were in 1933; (d) the current hopeful fiscal condition of the district is primarily attributable to the present plan and secondarily to the providential water supply which has enabled the district to earn unprecedented revenue from its power facilities during the last two or three years. In particular the court notices the testimony of Dr. Benedict and the Benedict report and the evidence of the witness Momberg (*In re Merced Irr. Dist.,* 25 Fed. Supp. 981, at page 985, and see formal findings R. 214).

There is no showing that the district can pay a higher tax rate than the plan requires without delinquencies that rapidly pyramid. Once the tax rate goes above a safe rate

12. Note also reports by Districts Securities Commission (Exs. 29-33, R. 678-732) on ability of district to pay.

what has been aptly called the "galloping disease" of insolvency is in full sweep. In truth anyone familiar with irrigation districts and particularly the Merced Irrigation District, will realize at once that even such tax rate as the plan will require is exceedingly precarious from the standpoint of the R. F. C.

Appellants speak of the almost unlimited funds that could be raised by increasing the tax rate in the cities of Merced, Atwater, etc. But here they show an utter lack of comprehension of the practical working of the tax in an irrigation district. They grind incessantly. They take no account of good times or bad times, of drought or flood; if they are not paid they are cumulated in the next year and in the next and the next. If the rate exceeds what the agricultural lands can pay they go delinquent and the delinquencies go on to the city. And in the city they go from one piece of property to another like a house of cards falling down until they cumulate to a point that nobody can pay and there is utter collapse.

All parties here conceded refinancing was essential (R. 495). But in all the years that have elapsed since the district attempted to refund, dissenting bondholders right up through the trial did not even attempt to put forward any plan much less any alleged fairer plan. At times they mentioned the First Refunding Plan, but without any particular enthusiasm. Confronted by a request from the court at the conclusion of the evidence that a modified plan be submitted, appellants (R. 164-167) modestly suggested that a "fairer" plan would be to give the dissenting bondholders 100% of their principal with some minor adjustment of interest; in other words, give over 90% of the

creditors who make the adjustment possible little more than 50% of their principal and give the dissenters 100%.

Respecting this proposed modification the court points out that it is "inequitable, discriminatory, illegally preferential and unjust"; it "financially penalizes approximately 91% of the bondholders who consented to the plan" and permits "less than 10% * * * to reap an unjust enrichment" (25 Fed. Supp. 985); also, the trial court holds the suggested change would upset present and prospective necessary improvements and throw the entire contractual arrangement with the R. F. C. into uncertainty.

It is respectully submitted the foregoing is a complete refutation of the argument against the fairness of the plan and that it meets the strict standards of the *Los Angeles Lumber Products Company* case, *supra.* See also the arguments and discussions in:

In re Corcoran Irr. Dist., 27 Fed. Supp. 322;

In re Lindsay-Strathmore Irr. Dist., 25 Fed. Supp. 988;

Supreme Forest Woodmen Circle v. City of Belton, 100 Fed. (2d) 655;

Getz v. Edinburg etc., School Dist., 101 Fed. (2d) 734;

In re Drainage Dist. No. 7, 25 Fed. Supp. 372;

Vallette v. City of Vero Beach, 104 Fed. (2d) 59 (certiorari denied by Supreme Court Oct. 9, 1939).

On the other hand, if overwhelming consent and benefit to bondholders are factors, as the Supreme Court seems to imply in its action in denying certiorari in *Luehrmann v.*

Drainage Dist. No. 7, 104 Fed. (2d) 696, it is not even debatable the plan is fair and equitable and should be confirmed.

Answer to the Specific Contentions of Appellants Under Fourth Proposition:

Appellants list many objections, most of them supercritical, which they claim render the plan unfair. They point to a few trees but give the court no idea of the forest. They do not review the evidence as a whole to show it does not sustain the finding that the plan is fair. For the most part they have been answered herein and the *Luehrmann v. Drainage Dist. No. 7,* 104 Fed. (2d) 696, specifically overrules many of them; nevertheless without further review of the *Luehrmann* case we supplement the answers as follows:

A. The Plan is Not Discriminatory.

(1) *All* creditors are offered $515.01 for each $1000 bond. The R. F. C. merely advances the money necessary to make the composition effective and in turn accepts refunding bonds for the total amount. No other form of composition would be practicable.

(2) The money which the R. F. C. used to purchase the bonds was put up in the interest of the creditors and the district alike. No new money could be secured without interest and this was new money thrown into an insolvent enterprise. It brought up the value of the bonds from 18 cents on the dollar to more than 50 cents (per Judge McCormick, *Merced* case p. 985). If the R. F. C. offer were withdrawn today the bonds would scarcely have even a nominal value.

Obviously it was proper to pay interest on this new money. *Luehrmann v. Drainage Dist. No. 7,* 104 Fed. (2d) 696; *Zavelo v. Reeves,* 227 U. S. 625, 33 S. Ct. 365, 57 L. Ed. 676. The benefit which accrued to the creditors and the district clearly justified the payment. Furthermore, dissenting bondholders could have taken cash at any time since the first disbursement was made by the R. F. C. and the money so taken would have had the earning power of interest. They voluntarily chose to relinquish the earning power or interest by holding their bonds.

(3) All bondholders were treated alike. There was no discrimination. Appellants were entitled to 4% on the liquidating value of their bonds from the time they were made available for refinancing up to October 4, 1935 (R. 761). Thereafter cash was available at all times (R. 351). This is precisely what all bondholders were offered and there was no favoritism. Appellants have chosen voluntarily to waive the income on the liquidating value of their bonds.

The case of *In re James Irrigation District,* 25 Fed. Supp. 974 at 975, does not support appellants' claim. In that case the interest which the court ordered paid had been paid in all transactions with all consenting creditors (p. 975). The same situation did not exist in either the *Merced* or the *Lindsay-Strathmore* cases decided the same day and by the same judge (McCormick). *In re Merced Irr. Dist.,* 25 Fed. Supp. 981; *Lindsay-Strathmore Irr. Dist.,* 25 Fed. Supp. 988. In neither of these cases, accordingly, was there any requirements for the payment of interest.

4. There is no authority under the law for the Merced Irrigation District to readjust or refinance the obligations of other independent taxing agencies. The plan cannot be unfair in respect to a power which the district could not lawfully exercise. See answer to Tenth Proposition (a), *infra.*

5. The plan does not take property from the bondholder and give it to a junior encumbrancer. Nor is there any similarity between a private corporation and a public agency in the respect noted. See answer to Tenth Proposition (a), *infra.*

B. The Plan is Not Unfair, Inequitable or Against the Best Interest of Creditors.

(1) The plan does not take trust funds or properties from appellants. All bondholders are in precisely the same class and the $515.01 for each $1000 bond represents the prorated cash value of the maximum load the district can carry.

(2) The bondholder does not give up over 53% of his investment or any part thereof "in order to benefit the landowner." The senior creditor does not give up anything. The $515.01 represents a value his bond did not have except for the relief accorded by the R. F. C. and the plan itself. The value of the bond was already largely gone. The plan gave it back in part. The bondholder gives up no value but gets $515.01 for a bond which was worth about 18 cents on the dollar on the market (R. 500).

(3) Appellants say that if inflation comes the district can liquidate its debts fully with "comparative ease." We will not debate such speculative questions. However,

if inflation comes and appellants still hold their bonds, they may then have very little value, in fact no value comparable with $515.01 in cash today.

(4) Appellants argue that it is impossible to submit a fair plan on a cash basis because no one can tell what the future will bring forth. This is interesting but not enlightening. Refinancing was conceded to be essential and the law authorized a composition offer in cash.

(5) The finding of the Districts Securities Commission on the value of the property is immaterial for the purpose of this proceeding and does not go to the fairness of the plan as the only security for the bonds is the earning power of the district. The value of the land is not the issue but the ability of the land to pay.

(6) What the district could pay was for the court to determine—not the Securities Commission.

(7) It is said that the plan is unfair because petitioner has assets far exceeding its liabilities.

Assets of a public agency are not set up on its books for cash value purposes, but to show their cost. These assets are necessary for operation and maintenance of the project but cannot be used to service bonds. If value were the issue, there should be an immediate deduction from assets of $5,500,000, being the cost of relocating the Yosemite Valley R. R. But if, after such revision and others, it should be found that the assets exceed the liabilities, what of it? It is not the assets which measure the ability to pay bonds but earning power. As Judge Yankwich points out in the *Corcoran District* case, 27

Fed. Supp. 322, excess of assets over liabilities does not show ability to pay debts.

On page 65 of appellants' brief it is said that the average value of the lands within the district is about $135.00 per acre, based on the testimony of the witness Momberg. The value of the lands in the district is shown in the Benedict report (Ex. 35, p. 128). (And see Statement of Facts herein, p. 5, *supra.*) Moreover, the witness Momberg was testifying not with respect to the value of district lands generally but to *sales price* of the lands of California Lands, Inc. (R. 485).

(8) Appellants here discuss the power revenue of the district.

Power is dependent upon the most uncertain of all things—the weather. The average gross return from the power plant for 12 full years of operation was $444,939.33 per year. This includes the very dry year of 1931 when the gross revenue was $95,917.21 and the wettest two years (1937, 1938) when the revenue was $625,363.45 and $707,203.96, respectively (R. 407; Ex. 27; R. 676.)

What the plant actually produced over a cycle of 12 years is more important in determining what it will produce in the future, than a theoretical study which goes back to 1872 and is based on what the plant should have been producing had it been in operation. Experience in actual operation is the best test. Dry cycles are impossible to predict, and as pointed out by appellants' witness, Hill (R. 536): "Speaking in terms of dry cycles, if a person were to attempt before that dry cycle commenced

to predict what the future would be, based on the past, he would not get it right." Mr. Hill had made a report on the district in 1924 before the power plant was installed as to what it would produce "based on the experience of the past," and did not "get it right." Before the plant had been built he predicted "based on the experience of the past that the yield would vary from a *minimum of $300,000* to a maximum of $700,000 per year" (R. 536-538).

The value of the power revenue to the district was given full consideration by the R. F. C. in its loan. Without a prospective high yield in power revenue, the R. F. C. would have paid much less than 50% for the bonds. Due weight was also given to the contract for sale of power which is a very favorable one. It will expire in 1964 (R. 946). Thereafter, no one can conjecture what the price of power will be, considering that Central Valley, Grand Coulee, Bonneville, Boulder Dam and other projects may be fully developed; neither can it be profitably conjectured as to whether in the next ten or fifteen years there may not be a series of dry years which would practically wreck the district; or, conversely, there may be a series of wet years which will bring in increased power revenue but greatly increase the amount of money to be paid for operation of the district in taking care of high water conditions and protecting against floods (R. 513). The power revenue is an interesting thing to play with in making speculations and conjectures. But no conservative financial man would give a greater weight to that revenue than was given by the R. F. C.

The trial judge sums up the power situation, very clearly and accurately, pointing out that the water supply during the last two or three years has been "providential" and enabled the district to earn

> "unprecedented revenue from its power facilities. But the experiences of the past, as shown by the record before us, do not warrant a finding that power revenue conditions similar to those existing will continue in the future, and it would be injudicious to venture the further financial ability of the District to meet its obligations upon problematical water sources or conditions. This would be too dubious a situation to warrant adoption by the court." (25 Fed. Supp. 986.)

9. It is said that petitioner could pay off its debt in full on petitioner's own theory. The contrary is shown by every syllable of testimony. Delinquencies have been reduced because the tax rate has been kept low. The cash reserves are the result of the operations of the R. F. C., the fact that maintenance expenditures have been deferred, capital operations postponed and to a "providential" power yield.

10. It is said here that the district comprises a fertile and good section of the state.

Without taking issue with appellants on this, we point out that for the purpose of this proceeding the condition of the district, the value of its lands, and the ability to pay assessments are best covered in the Benedict report, including the classification of lands by Mr. Cone (Ex. 35, pp. 126-133), the testimony of Dr. Benedict and Mr. Momberg (R. 432 to 494) and the letter of the bondholders' committee dated December 15, 1933 (Ex. 37, R. 736).

11. A sufficient answer here is that the exhibits presented by petitioner showing its financial condition were practically as of the date of trial (Exs. 22-28, R. 661-678).

ANSWER TO FIFTH PROPOSITION: "THE CLAIMS WERE IMPROPERLY CLASSIFIED AS BEING ALL OF THE SAME CLASS."

1. On Appellants' Theory There Would Be About 200,000 Classes.

If we correctly understand appellants, they argue that "Each matured bond and coupon when presented for payment becomes a separate class" (Apps.' Brief, p. 75). There are roughly 16,000 bonds in the Merced issue. Each carries two coupons a year, no interest has been paid since July 1, 1933, and practically all of the coupons have at varying times been presented for payment and registered unpaid for want of funds. In addition, $386,000 in principal was in default at time of trial (R. 401) and these bonds too, have been presented for payment and registered. Most of them are owned by the R. F. C. (Apps.' Brief, p. 60).

If, as appellants claim, each such matured bond and coupon becomes "a separate class" (Brief, p. 75) there will be about 200,000 classes.

2. On the Facts Appellants Show No Injury.

Passing this, however, and assuming that there is a priority or preference as between bonds and coupons in bankruptcy, appellants wholly fail *on the facts* to show any injury from the alleged failure of the court to classify. A mere showing that appellants' own matured

bonds and coupons which have been presented for payment and registered is not enough because the record shows that *all of the bonds and coupons held by the R. F. C. have also been presented for payment and registered.* The mere registration of the bonds in the name of the R. F. C. as owner is, under *Bates v. McHenry,* 123 Cal. App. 81, at p. 92, 10 P. (2d) 1038, an automatic presentation and registration. And prior to the registration of the bonds in the name of the R. F. C. as owner the former owners were vigilant in presentation for payment.

The bond register of the district showing the exact order of presentation of matured bonds and coupons was not put in evidence for the reason that appellants did not make any point of it at the time of trial. A long and tedious accounting would be required to fix the exact order of presentation. But the testimony is clear that the bonds and coupons held by the R. F. C. have at least as early presentation dates as those of appellants (see R. 520, 887). While the record, therefore, is admittedly incomplete, it wholly fails to show that appellants are injured by failure to classify in accordance with presentation. If that was required, they show no facts (Brief, p. 76) that do not equally apply to the R. F. C.

If the money in the treasury of the district is to be paid out to those having matured bonds or coupons in the order of their presentation for payment, it is quite sure that the R. F. C. will get at least 90% of the available funds and probably a great deal more because appellants will not deny that, for the most part, it holds the earliest presentations. In any event, the burden is upon

appellants to show not only that the court erred in failing to make classification but that they were injured by it.

Scritchfield v. Kennedy, 103 Fed. (2d) 467;
In re Schulte-United Inc., 59 Fed. (2d) 553;
Moores Fed. Practice, Vol. 3, p. 3285, Sec. 61.

3. There is, However, in Bankruptcy No Preference or Priority Based on Presentation.

In the *amicus curiae* brief of the Imperial Irrigation District Bondholders Committee filed in the *Lindsay-Strathmore Irrigation District* proceeding in this court, No. 9206, the authorities are elaborately reviewed and it is shown that the bankruptcy act takes cognizance only of "true priorities"—that priorities created by the state are not recognized if they are "destructive of the purpose and spirit of the bankruptcy act." *Local Loan Co. v. Hunt,* 292 U. S. 234, 54 S. Ct. 695, 93 A. L. R. 195, 78 L. Ed. 1230 at p. 1236. The bonds here are all clearly equal and payable without preference out of annual assessments. They are all in the same class. There can be no preference as between them. It is the general spirit of bankruptcy to ignore "advantages" based on legal proceedings or winning a "race" to the cash register (see: *Vallette v. City of Vero Beach,* 104 Fed. (2d) 59, p. 63, certiorari denied Oct. 9, 1939; *Luehrmann v. Drainage Dist. No. 7,* 104 Fed. (2d) 696, certiorari denied Nov. 6, 1939).

True priorities cannot arise in this case even if *Bates v. McHenry* holds all that appellants contend. We shall not retrace the ground covered in the *amicus curiae* brief in so far as the rule in bankruptcy is concerned but will merely supplement the briefs in the *Lindsay-Strathmore*

case by showing that under the doctrine of *Bates v. McHenry, supra,* and the California law there is no priority or preference.

Bates v. McHenry, supra, and subsequent cases cited by appellants do not establish the California rule as they contend. They establish the opposite, namely, that once the fund is not replenishable, in other words, when bankruptcy intervenes, there is no preference but all creditors are equal. A careful reading of the cases will show that this is true.

Judge McCormick in his opinion in *In re James Irrigation District,* 25 Fed. Supp. 974 at 975, clearly, correctly and forcefully states the California rule and shows there is no preference under the state law. In the *amicus curiae* brief filed by Lynn Atkinson in the *Lindsay-Strathmore* proceeding here, No. 9206, the opinion on this point is said, at page 51, to be a "rather superficial opinion" but it is not the opinion which is superficial, but counsel's reading of the California cases.

A close study of *Bates v. McHenry* and subsequent cases will show that preference was never intended to be applied where there is insolvency and the fund is not replenishable.

Bates v. McHenry, 123 Cal. App. (at pp. 91, 92) 10 P. (2d) 1038, definitely recognizes that the rule would be different in case of insolvency. The decision is based upon the ground that all bondholders will be paid in full out of a replenishable fund. Those who are not paid on presentation receive 7% interest. "Thus, *absolute equality* is meted out between the coupon holder who receives in-

stant payment and the coupon holder whose payment is deferred."

Shouse v. Quinley, 3 Cal. (2d) 357, 37 P. (2d) 89, 45 P. (2d) 701, again, did not deal with insolvency; it merely held that to permit application of bonds on assessments would reverse the normal order of payment as provided by Section 52. Clearly the law there involved was unconstitutional, and the case not only affords no support for appellants but establishes that *no preference can be allowed in favor of bondholders as against others holding registered bonds.*

In *Selby v. Oakdale Irrigation Dist.,* 140 Cal. App. 171, 35 P. (2d) 125, it is again recognized, citing *Bates v. McHenry,* that there is ordinarily no priority as to any of the bonds issued by the irrigation district. There is nothing in that case to support the claim that Section 52 would be applied in bankruptcy.

Passing the decision in *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 P. (2d) 116, and companion cases, for the moment, it is manifest that all of the irrigation district cases cited by appellants are cases which do not involve insolvency, and a reading of these cases carefully—particularly the leading case of *Bates v. McHenry* —will demonstrate that they all recognize that any priority will disappear in the event that the fund is not replenishable.

Turning now to the reclamation district cases, it will be found that, commencing with *Rohwer v. Gibson,* 126 Cal. App. 707, 14 P. (2d) 1051, they all recognize that the annual funds must be prorated among the maturities for

the year, for the simple reason that in a reclamation district such annual funds are not replenishable. In other words, *they are direct authority for the rule that if the fund is not replenishable the money must be prorated.* Furthermore, these reclamation district cases distinguish the irrigation district cases upon the very ground that the holder of a bond of an irrigation district "relies upon the inexhaustible taxing power of the district." Obviously, however, if bankruptcy intervenes and the district is insolvent, or in the language of the Bankruptcy Act "unable to pay its debts as they mature," there is nothing to rely on for the replenishment of the fund.

The rule in reclamation districts has even been carried so far that if the reclamation district is insolvent then the holders of *all bonds, matured* and *unmatured,* are entitled to share in any available funds. This was so held by the Third District Court of Appeal in the recent case of *Morris v. Gibson,* 30 Cal. App. (2d) 684, 87 P. (2d) 37, although the district in that case was held not to be insolvent. The *Sturdivant Bank* case cited therein with approval (68 S. W. (2d) 671, Mo. 1934) and also the case of *Groner v. U. S.,* 73 F. (2d) 126, are particularly interesting and demonstrate that once insolvency is established or bankruptcy intervenes, there can be no preference. There must be equality.

Summarizing the reclamation and irrigation district cases to date, it appears that both lines of cases recognize that where funds applicable to the payment of bonds of the same class cannot for any reason be replenished, equality is equity and the money must be prorated. It is because ordinarily in a reclamation district the annual

fund is *not* replenishable and because in an irrigation district it ordinarily *is* replenishable that we have one situation in a reclamation district (evidenced by *Rohwer v. Gibson, supra*) and another situation in an irrigation district (evidenced by *Bates v. McHenry, supra*).

Of course, the answer to everything that appellants claim is found in the case of *Kerr Glass Manufacturing Corporation v. San Buenaventura,* 7 Cal. (2d) 701, 62 P. (2d) 583, which is doubtless conclusive because it fully discusses the applicable general principles; and it does not help appellants to pass this off as a special assessment case any more than it does to pass the reclamation district cases off as involving special funds, for the reason, as noted above, that the principles underlying these cases, 'the reason for the rule', definitely support our thesis.

The case of *District Bond Company v. Cannon* (20 Cal. App. (2d) 659, 67 P. (2d) 1090) upholding and following the *Kerr Glass Manufacturing Corporation* case, is further authority for our contention as well as *Strasburger v. Van Delinder* (17 Cal. App. (2d) 437, 62 P. (2d) 387) in which, however, there was no showing that the fund could not be replenished.

It is really the case of *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 P. (2d) 116, and companion cases, upon which appellants rely. But a careful examination of these cases will show that the cases themselves are not only not contrary to our theory, but definitely support it. Obviously (there being nothing else involved) to permit one group of bondholders, as in the case of *El Camino Irr. Dist. v. El Camino Ld. Corp.* (12 Cal. (2d) 378, 85 P.

(2d) 123), to take the lands of an irrigation district on execution would *give them a preference as against bondholders who had presented their bonds for payment.* This, however, does not mean that in a proper case *all* bondholders would not have to share in the common fund. The court says on page 374 of 12 Cal. (2d) of the *Provident Land Corporation v. Zumwalt* case that where a surplus exists "first, this money should go to the bondholders; and second, in any event, *it should not be given to junior bondholders in preference to those with prior claims,* but should be paid on past due bonds and coupons in the order of their presentation." If these sentences are lifted from the decision, unrelated to its other parts, they may be confusing. But not if it is remembered that junior bondholders had secured a preference as against registered bondholders in that case and it was this preference which the court by its decision set aside. In that case the question was simply whether the district had made an erroneous and unlawful distribution of money from the bond fund, or which should have been in the bond fund, to bondholders who admittedly were not entitled to it. Of course, if the money should have gone into the general fund the district clearly could not disburse it so as to create a preference as against bondholders who held the prior registration. Later in the decision it is made clear that the court is not abandoning the rule of the *Kerr Glass Manufacturing Corporation* case, 7 Cal. (2d) 701, 62 P. (2d) 583, because it is definitely referred to with approval and, concluding the decision, as if to forestall any possibility of misconstruction, the court in the *Provident* case, speaking of the *Kerr* case, says at page 379:

> "* * * we recognized the justice of applying equitable principles to the payment of bondholders in unusual circumstances, notwithstanding the fact that express provisions of the statute stood in the way."

And then the court says (quoting):

> " 'The trust status of the fund has been considered appropriate where it is theoretically replenishable by a so-called inexhaustible taxing power, but the exercise of that power is rendered fruitless by reason of economic conditions resulting in a tax-collecting incapacity.' "

There can be no question that had the same question we are considering here been involved or raised in the *Provident Land Corporation v. Zumwalt* case the court would have applied the rule of the *Kerr Glass Manufacturing Corporation* case and held that there was no preference in the common fund.

Appellants seek comfort in the modification of the opinion in the *Provident Land Corporation v. Zumwalt* case. In the Irrigation Districts Association amicus curiae brief, however, in the *Lindsay-Strathmore* proceeding here, No. 9206, at page 25, et seq., the full request for modification (with certain vital parts omitted by appellants) is quoted. From this it appears that the reference by the California Supreme Court to the *Kerr Glass* case in *Provident Land Corporation v. Zumwalt* case was purposeful and the meaning attempted to be put on the modification of the opinion by appellants entirely loses its significance.

We shall not retrace the history of the modification as it is fully set forth in the amicus brief. It is obvious,

however, that the California Supreme Court wished to protect its opinion as against the very construction now placed upon it by appellants.

ANSWER TO SIXTH PROPOSITION: "THE DECREE UNLAWFULLY TAKES TRUST FUNDS AND VESTED RIGHTS BELONGING TO THE APPELLANTS."

Here appellants go around in a circle. They say that because the district held certain property in trust "for the uses and purposes" set forth in the "Irrigation District Act", including the payment of bondholders, and because there was a vested right to a writ of mandate and the levy of assessments at the time the district filed in bankruptcy, and because these rights are affected by the bankruptcy decree, therefore the decree must be invalid. The proposition advanced is a negation of the whole theory and philosophy of bankruptcy except to the extent that the decree is alleged to have destroyed liens or preferences. It has been shown, however, under the answer to the Fifth Proposition that there is no lien or preference as between the bondholders.

The very object of bankruptcy laws "is the equitable distribution of the debtor's assets amongst his creditors".

In *Kuehner v. Irving Trust Co.*, 299 U. S. 445, 57 S. Ct. 298, 81 L. Ed. 340 at 345, the court pertinently says:

> "The short answer is that the object of bankruptcy laws is the equitable distribution of the debtor's assets amongst his creditors"

even though the debtor's contract is impaired.

At page 346:

> "(The Fifth Amendment) does not prohibit bankruptcy legislation affecting the creditors' remedy for its enforcement against the debtor's assets or the measure of the creditors' participation therein if the statutory provisions are consonant with a fair, reasonable and equitable distribution of those assets."

And at page 346:

> "Bankruptcy originated as a seizure of the debtor's assets for equitable distribution amongst creditors."

The purpose of reorganization proceedings under Sec. 77B[13] was to "facilitate rehabilitation" by "scaling or rearrangement" of obligations,

> "thus avoiding a winding up, and sale of assets, and a distribution of the proceeds."
>
> *City Bank Farmers Trust Co. v. Irving Trust Co.,* 299 U. S. 433, 57 S. Ct. 292, 81 L. Ed. 324 at 329.

In *Louisville Joint Stock Land Bank v. Radford,* 295 U. S. 555 at p. 585, 55 S. Ct. 854, 79 L. Ed. 1593 at p. 1602, the court says:

> "So far as concerns the debtor, the composition is an agreement with the creditors in lieu of a distribution of the property in bankruptcy—an agreement which 'originates in a voluntary offer by the bankrupt, and results, in the main, from voluntary acceptance by its creditors * * *"

13. Composition proceedings present a much stronger case (see discussion of *Case v. Los Angeles Lumber Products Co.*, decided November 6, 1939, at pp. 55, et seq., *supra.*

ANSWER TO SEVENTH PROPOSITION: "BY THE TERMS OF THE STATUTE THE COURT WAS WITHOUT JURISDICTION."

Under this heading appellants make a labored argument designed to prove that, although the Supreme Court in the *Bekins* case, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137, held that Sections 81 to 84 of the Bankruptcy Act were constitutional as applied directly to an irrigation district organized under the California Irrigation District Act, there have been late cases decided by the California Supreme Court which establish some entirely new and novel rule with respect to the status of irrigation districts, and that therefore the *Bekins* case should be disregarded.

Appellants take this position notwithstanding that (a) the very basis for the decision in the *Bekins* case in the lower court was that an irrigation district is an agency of the state performing governmental functions and within its sphere exercising the "powers of sovereignty" (*In re Lindsay-Strathmore Irrigation District,* 21 Fed. Supp. 129 at page 134); and (b) that this question is fully considered in the briefs in the United States Supreme Court.[14]

Judge Yankwich who wrote the learned opinion in *In re Corcoran Irr. Dist.,* 27 Fed. Supp. 322, in the lower court, and who ought to know, points out at page 328, that the recent decisions of the California Supreme Court relied upon by appellants, "have not changed the law as I found it to be" in the first *Lindsay-Strathmore Irriga-*

14. At page 1140 of 82 L. Ed. abstract of briefs of the parties in the *Bekins* case. Mr. Cook and Mr. Childers representing many of appellants here, cite *Moody v. Provident Irr. Dist.,* 77 P. (2d) 253 on the governmental nature of irrigation districts. In the decision of the California Supreme Court on rehearing the same language on the governmental nature of irrigation districts is adopted verbatim. *Moody v. Provident Irr. Dist.,* 12 Cal. (2d) 389, at 394, 85 P. (2d) 128.

tion District case, 21 Fed. Supp. 139. And he adds that the decision of the Supreme Court in the *Bekins* case "is proof that the court understood the nature of California irrigation districts".

The late California decisions cited by appellants do not purport to state any new rule. They do not reverse or modify earlier decisions but merely reaffirm a principle long recognized and established in California with respect to both irrigation and reclamation districts, namely, that they are public agencies vested with attributes of sovereignty and governmental in character. There is slight difference in the shading of the language used from time to time by the California court respecting these agencies but, in the essential attributes its characterization of these districts has consistently remained the same. A mere reading of the recent decisions cited by appellants will show that the Supreme Court was reiterating the rule theretofore uniformly adhered to and applied and that the recent cases add nothing to the rule but on the facts, make a fresh application of familiar principles.

The following cases, all decided prior to the *Bekins* case, are but a few of a list which might be almost indefinitely lengthened:

Sutro Heights Land Co. v. Merced Irr. Dist. (1931), 211 Cal. 670, 690, 296 P. 1088, 1096, 1098;

Nissen v. Cordua Irr. Dist. (1928), 204 Cal. 542, 545, 269 P. 171;

Whiteman v. Anderson-Cottonwood Irr. Dist. (1922), 60 Cal. App. 234, 237, 212 P. 706;

Morrison v. Smith Brothers Inc. (1930), 211 Cal. 36, 40, 293 P. 53, 54;

In re Madera Irr. Dist. (1891), 92 Cal. 296, 28 P. 272, 675, 14 L. R. A. 755, 27 Am. St. Rep. 106;
People v. Sacramento Drainage Dist., 155 Cal. 373, 382, 103 P. 207;
Bettencourt v. Industrial Acc. Com., 175 Cal. 559, 561, 166 P. 323;
Western Assur. Co. v. Drainage Dist., 72 Cal. App. 68, 72, 237 P. 59;
Wood v. Imperial Irr. Dist., 216 Cal. 748, 753, 17 P. (2d) 128;
La Mesa etc. Dist. v. Hornbeck, 216 Cal. 730, 737, 17 P. (2d) 143.

But aside from the foregoing, appellants miss the entire point of the *Bekins* case, which is that a voluntary proceeding brought by an irrigation district with the consent of the State cannot in any sense "interfere" with the sovereignty of the State. The very issue determined was that such a proceeding is not "interference". And in making the point under discussion, appellants are simply disregarding realities and asking this court to overrule the Supreme Court.

In *Supreme Forest Woodmen Circle v. Belton,* 100 Fed. (2d) 655, the court refers to the *Bekins* case and says at page 657:

> "* * * It sustained the act as to the Irrigation District on the ground that it was not an attempt to interfere with its governmental functions."

And again, at page 657, it says concerning the act:

> "* * * it concerns itself with the city as a debtor, not compulsorily, nor by way of interference with it, * * *"

Manifestly under the *Bekins* decision when the agency of the State, with its consent, seeks the aid of the bankruptcy court voluntarily, it acts for the benefit of and not in derogation of its sovereignty. Therefore it cannot be said that the proceeding interferes with the State sovereignty or with the exercise of governmental functions.

ANSWER TO EIGHTH PROPOSITION: "THERE IS ANOTHER ACTION PENDING IN THE STATE COURTS * * *."

Appellants contend that because a proceeding under the "Irrigation District Refinancing Act" (Cal. Stats. 1937, Chap. 24) in the state court was partially tried, petitioner is precluded from offering a plan of composition under Chapter IX of the Bankruptcy Act.

The state act, as has been pointed out in our statement of the case (p. 15, *supra*), provides for condemnation of bonds of dissenting bondholders. The public necessity and foundation for condemnation are first shown at a preliminary trial after which an interlocutory judgment supported by findings of fact is entered, or if the proof fails, the proceeding is dismissed (Sec. 8). In the former situation, the right to condemn has been established and thereafter the case proceeds as an ordinary condemnation proceeding at which the value of the dissenting bonds are fixed by trial. Upon payment of the value so fixed the bonds are taken for public use (Secs. 10-11).

The state action in question had proceeded merely through the preliminary stages and the judge had announced a decision in favor of the district on the right

to an interlocutory judgment. As heretofore pointed out in our statement of the case, nothing further was done. The district elected to claim the benefits of bankruptcy composition after the Supreme Court held Sections 81-84 constitutional and this proceeding is the result.

Heretofore appellants insisted that the state act is a bankruptcy act impairing the obligation of contracts and that it is unconstitutional and void.

Morris v. South San Joaquin Irrigation District, 9 Cal. (2d) 701 at 704, 72 P. (2d) 154.

That is primarily the ground upon which the state proceeding was resisted.

Of course, if this contention is sound and the act impairs the obligations of the contract, it is simply void and ineffectual.

International Shoe Co. v. Pinkus, 278 U. S. 261, 49 S. Ct. 108, 73 L. Ed. 318.

On the other hand, if the state act is not a bankruptcy act, petitioner was entitled to the benefits of bankruptcy. Certainly because the district had commenced an action to condemn it did not forego the right granted it by Congress to effect a composition of its debts in bankruptcy.

In either event, it is plain that the state case was superseded by this proceeding.

Appellants say the authorities cited in their brief (pp. 98-99) support their contention that proceedings under state insolvency laws, pending at the time of passage of a federal bankruptcy act are not affected by the latter act. It is doubtful if they do support such claim but, if so, they

are bad law except insofar as the original Bankruptcy Act expressly saved certain state proceedings. This saving clause has since been stricken out.

Says Mr. Remington:

"Sec. 2104. *Basis of Supersedence, Paramount Authority Conferred by Constitution, and Necessary Implication from Sec. 70.*—The superseding of State bankruptcy and State insolvency proceedings comes about from the fact that the Constitution of the United States in Article 1, Sec. 8, authorizes Congress 'to establish * * * uniform laws on the subject of bankruptcies throughout the United States'; and that Sec. 71 of the original Act, 11 U. S. C. A. Sec. 111 (since stricken out on Amendment as being no longer necessary), providing that 'Proceedings commenced under State insolvency laws before the passage of this Act shall not be affected by it', necessarily implies the superseding of all other classes of State insolvency proceedings than those expressly excepted."

Remington on Bankruptcy, Vol. 5, Fourth Edition, Sec. 2104, page 192.

From 8 C. J. S., p. 422:

"A state court may be prohibited from acting under a state insolvency law and any proceedings under such a state law commenced after the national law went into effect are void and ineffective, except that *where proceedings are commenced under a state act that is not in reality a bankruptcy act but is in harmony with the federal Bankruptcy Act and in aid of its purpose, while all proceedings thereunder are superseded when a bankrupt proceeding is begun, the bankruptcy court may avail itself of the status and*

proceedings then existing in the state court where such status or proceedings may aid in the administration by the bankruptcy court of the bankrupt's property.''

From

First National Bank of Delta, Pa. v. Weaver, 296 Fed. 112, at p. 114:

"It will thus be seen the state act in question is not a bankruptcy act, but one of insolvency administration, and while all proceedings thereunder are, of course, superseded when a bankrupt proceeding is begun, yet there is no reason why the bankrupt court should not avail itself of the status and proceedings then existing in the state court proceeding where such status or proceedings may aid in the administration by the bankruptcy court, of the bankrupt's property.''

In *In re Dressler Producing Corporation,* 262 Fed. 257, p. 259, the court says:

"'* * * We are of the opinion that it was unnecessary to justify a choice, for the petitioners in bankruptcy have the unchallengeable right to proceed by filing this petition. The institution of the proceedings in the state court is not a bar to maintenance of this petition in bankruptcy.''

In *In re Ellsworth,* 277 Fed. 128, the court held that the jurisdiction of a state court in a suit is at once superseded by an adjudication in bankruptcy against the defendant therein, and it is without authority to proceed thereafter; but, where it does so, its judgment against the bankrupt may be accepted by the bankruptcy court as a liquidation of the plaintiff's claim, under the Bankruptcy Act, Section 63b.

In *Collins v. Welsh,* 75 Fed. (2d) 894, 99 A. L. R. 1319, Circuit Judge Wilbur, speaking for this court, held that federal bankruptcy jurisdiction over property of petitioner seeking composition with his creditors superseded state court jurisdiction which had already attached to certain of his property. He points out that the jurisdiction of the bankruptcy court is necessarily paramount. And he further points out that in *In re Faour,* 72 Fed. (2d) 719, where the superintendent of banks of the State of New York, acting under a state law had taken possession of the property of the debtor before the filing of the petition in the bankruptcy court, it was held that the state jurisdiction was superseded, the court saying at page 720:

> "Within its sphere the jurisdiction of a court of bankruptcy is paramount."

So also in *U. S. Bank etc. v. Pamp,* 77 Fed. (2d) 9, 99 A. L. R. 1370, it was held that where a farmer who filed a petition in bankruptcy for a composition with creditors or extension of time to pay debts is still in possession of mortgaged realty against which a decree of foreclosure has been obtained, the bankruptcy court has jurisdiction summarily to enter a decree restraining further prosecution of the foreclosure. This for the reason that bankruptcy jurisdiction when invoked "is paramount", or, as it is sometimes put "supreme" and "exclusive" and "unrestricted".

International Shoe Co. v. Pinkus, 278 U. S. 261, 49 S. Ct. 108, 73 L. Ed. 318;

New York v. Irving Trust Co., 288 U. S. 329, 53 S. Ct. 389, 77 L. Ed. 815;

U. S. Fid. etc. Co. v. Bray, 225 U. S. 205, 32 S. Ct. 620, 56 L. Ed. 1055;

In Re Bank Shares Corporation, 50 Fed. (2d) 94, p. 95;

In Re Drake Motor and Tire Mfg. Corp., 16 Fed. (2d) 142, 145;

In re Mullings Clothing Company, 238 Fed. 58, p. 66;

In re Diamond's Estate, 259 Fed. 70, p. 73;

Louisville Realty Co. et al. v. Johnson, 290 Fed. 176, p. 177.

ANSWER TO NINTH PROPOSITION: "IT IS RES JUDICATA BETWEEN THE PARTIES THAT THE CONSTITUTION FORBIDS THE RELIEF SOUGHT."

1. Appellants argue that the new Municipal Bankruptcy Act is the same law as the old and that the *Bekins* case, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137, overruled the *Ashton* case, 298 U. S. 513, 56 S. Ct. 892, 80 L. Ed. 1309. If this be not true their entire argument is pointless because the most they can claim is that the former judgment is conclusive, that Congress had no power to enact Section 80. But if Sections 81-84 are different from Section 80 in fact as well as section number what was determined as to Section 80 can have no bearing on Sections 81-84.[15]

The short answer to appellants' contention, therefore, is that the Supreme Court did regard the two laws as different and did not overrule the *Ashton* case. On the con-

15. The issue of *res judicata* also was apparently involved in *Luehrmann v. Drainage Dist. No. 7,* 104 Fed. (2d) 696, and resolved against appellants.

trary it expressly held that Congress in enacting the new law, was "especially solicitous" to afford no ground for the objection urged in the *Ashton* case. It is not for appellants to say the court did not mean what it said. In *Supreme Forest Woodmen Circle v. Belton,* 100 Fed. (2d) 655, it is aptly and tersely said on page 657 referring to the decision in the *Bekins* case:

> "* * * it adjudicates fully, completely, and without reservation, that the Ashton case is without bearing or effect on the present Act."

2. But in any consideration of this case the defense of *res judicata* fails. The former action was merely dismissed for want of jurisdiction. This means that, as of the date of dismissal, the court had no jurisdiction.[16] But if the court subsequently acquires jurisdiction by virtue of a new law or even by virtue of a reversal on constitutional grounds of the old law, that is a different story.

It is fundamental that *res judicata* is never applied where there has been a change in the law or the facts after the judgment has been rendered. Assuming that the *Bekins* case overruled the *Ashton* case and that the two laws are identical, the legal effect would be similar to a constitutional amendment. See in this connection dissenting opinion of Mr. Justice Brandeis in *Burnet v. Coronado Oil & Gas Co.,* 285 U. S. 393, 52 S. Ct. 443, 447, 448, 76 L. Ed. 815 at pp. 823, 824:

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16. We concede that jurisdiction or want of jurisdiction can become *res judicata* (*Treimics v. Sunshine Mining Co.*, ... L. ed. (Adv. Op.) ....., citation not yet available, decided by the U. S. Sup. Ct. Nov. 6, 1939), even if the decision on want of jurisdiction is erroneous.

"* * * But in cases involving the Federal Constitution, where correction through legislative action is practically impossible, this Court has often overruled its earlier decisions. The Court bows to the lessons of experience and the force of better reasoning, recognizing that the process of trial and error, so fruitful in the physical sciences, is appropriate also in the judicial function. * * * Recently, it overruled several leading cases, when it concluded that the States should not have been permitted to exercise powers of taxation which it had theretofore repeatedly sanctioned."

In a footnote, page 826:

"The policy of *stare decisis* may be more appropriately applied to constitutional questions arising under the fundamental laws of those States whose constitution may be easily amended. The action following the decision in Ives v. South Buffalo Ry. Co., 201 N. Y. 271, 94 N. E. 431, 34 L. R. A. (N. S.) 162 Ann Cas. 1912B, 156 shows how promptly a state constitution may be amended to correct an important decision deemed wrong. See Frankfurter and Landis, 'The Business of the Supreme Court,' pp. 193-198. In only two instances—the 11th and the 16th Amendments—has the process of constitutional amendment been successfully resorted to, to nullify decisions of this Court. * * * It required eighteen years of agitation after the decision in the Pollock Case to secure the 16th Amendment."

See also further discussion by the same author in his dissenting opinion in *Industrial Accident Commission of the State of California v. Rolph Company,* 264 U. S. 219, 44 S. Ct. 302, 68 L. Ed. 646 at 657, where a great many

cases are cited in which the United States Supreme Court has reversed its former holdings on constitutional issues.

In our case there has been a change since the former action was dismissed. The change may be considered as a change of facts or a change of law or what Mr. Chief Justice Hughes speaks of in the *Blair* case *infra* as the creation of a "new situation" and then *res judicata* fails.

The case of *Blair v. Commissioner of Internal Revenue,* 300 U. S. 5, 57 S. Ct. 330, 81 L. Ed. 465—decided February 1, 1937, makes clear that any subsequent change in the law operating on the first judgment renders *res judicata* ineffective. In that case the beneficiary of a trust who had assigned the income thereof was held liable for federal income taxes for a certain year on the income assigned. This was a decision of the United States Circuit Court of Appeals which had become final through denial of certiorari by the United States Supreme Court. The decision was predicated upon the law of Illinois holding that the trust was a spendthrift trust and therefore the assignment was invalid. After the judgment had become final, the Illinois courts held the trust was not a spendthrift trust and that the assignments were valid. The United States Supreme Court held that the *Tait* case (a primary reliance of appellants herein, see brief of Florence Moore, pp. 9, 11, 12, 16) was not applicable and that *res judicata* with respect to taxes in later years could not be upheld, saying, at page 469 (of L. Ed.):

> "* * * we think that the ruling in the Tait Case is not applicable. That ruling and the reasoning which underlies it apply where in the subsequent proceed-

ing, although relating to a different tax year, the questions presented upon the facts and the law are essentially the same. Tait v. Western Maryland R. Co. supra (289 U. S. pp. 624, 626, 77 L. Ed. 1408, 1409, 53 S. Ct. 706). *Here after the decision in the first proceeding, the opinion and decree of the state court created a new situation.* The determination of petitioner's liability for the year 1923 had been rested entirely upon the local law. Commissioner of Internal Revenue v. Blair (C. C. A. 7th), 60 F. (2d) 340, 342, 344. The supervening decision of the state court interpreting that law in direct relation to this trust cannot justly be ignored in the present proceeding so far as it is found that the local law is determinative of any material point in controversy."

In *Freeman on Judgments,* Fifth Ed. Vol. 2, Sec. 713, the rule is stated as follows:

"* * * Generally, however, a subsequent change in the law applied in arriving at the judgment defeats its operation as res judicata so far as dependent upon the continuance of that law."

"The estoppel of a judgment extends only to the facts in issue as they existed at the time the judgment was rendered, and does not prevent a reexamination of the same questions between the same parties where in the interval the facts have changed or new facts have occurred which may alter the legal rights or relations of the litigants. But in the absence of evidence to the contrary the facts as they existed at the time of the former judgment will be presumed to continue." (34 *Corpus Juris* 905.)

In *Third National Bank of Louisville v. Stone,* 174 U. S. 432, 19 S. Ct. 759, 43 L. Ed. 1035, it is held a decree

establishing the existence of an irrevocable contract exempting or limiting the taxation of a bank for the term of its original charter is not *res judicata* as to whether the bank is subject to taxation after that charter is renewed. Compare this with *Gunter v. Atlantic Etc. R. Co.,* 200 U. S. 273, 26 S. Ct. 252, 50 L. Ed. 486, also heavily relied on by appellants, where there had been no change of law or fact after the first judgment.

In *City of Shreveport v. Shreveport Rys. Co.,* 38 Fed. (2d) 945, 69 A. L. R. 340, it is held that a judgment upholding the validity of an ordinance requiring street cars to be manned by two persons, as applied to the conditions then existing and presented to the court, are not *res judicata* in a subsequent suit by the railway company against the city to enjoin the enforcement of the ordinance, where conditions have sufficiently changed to render the ordinance unreasonable and unnecessary, and its enforcement would operate to confiscate the company's property.

In *Quannah, A. & P. Ry. Co. v. Panhandle & S. F. Ry. Co.,* 67 Fed. (2d) 826, at page 828:

> "The contention of estoppel by judgment arises out of a proceeding between the same parties to restrain the revocation of a similar joint route and rate for other products filed May 15, 1933, and dismissed May 31, 1933, on the ground that the matter was within the exclusive jurisdiction of the Commission. That bill did not present and could not have presented, any question based on the Emergency Railway Transportation Act, for it became law more than two weeks after the judgment."

Snyder v. Commissioner of Internal Revenue, 73 Fed. (2d) 5, at page 6:

"The Commissioner of Internal Revenue found a deficiency tax against Snyder arising out of marginal transactions in the year 1928 which were similar in character to marginal transactions of the same taxpayer in 1925 on which this court passed in Snyder v. Commissioner, 54 F. (2d) 57. The Commissioner claims the decision in that case is res judicata of the matter raised on the present petition. Although the law may be the same, the facts, though similar, are different and, being different, they were not passed upon in that case. We hold against the Commissioner's contention of res judicata." (Affirmed *Snyder v. Commissioner of Internal Revenue,* 295 U. S. 134, 79 L. Ed. 1351, 55 S. Ct. 737.)

Stone v. Interstate Natural Gas Co., 103 Fed. (2d) 544, page 547:

"But the judgment would be no estoppel if the parties were the same, for the tax here involved is under a new and different law. The taxes imposed are similar, but the Legislature made the substitution in order to accomplish changes, especially a new and strange definition of 'doing business' discussed below, and the changes are sufficient to require a new determination" (certiorari was granted June 5, 1939).

Marcum v. Marcum, 70 Fed. (2d) 760, held:

Judgment in first contempt proceeding holding court was without power to punish husband for contempt for failure to pay counsel fees and costs allowed in divorce decree *held* not res judicata in subsequent contempt proceeding based on same default, where first judgment was erroneous under subsequent appellate court decision.

See also the following:

United Shoe Machinery Corp. v. United States, 258 U. S. 451, 42 S. Ct. 363, 66 L. Ed. 708;

L. R. A. 1918D page 253;

Bank of Eureka v. Partington, 91 Fed. (2d) 587, Ninth Circuit (July 28, 1937).

It is clear from the foregoing that the cases cited by appellants are readily distinguishable, and that none of them bear upon the issues here.

No man can acquire a vested right by way of estoppel as against a change in the constitution or fundamental law.

Recently the Supreme Court has limited or overruled former holdings with respect to the liability of state employees for federal income taxes and of federal employees for state income taxes (*Helvering v. Gerhardt,* 304 U. S. 405, 58 S. Ct. 969, 82 L. Ed. 1427).[17] Appellants would argue that if in some former holding, a state employee (e. g. Mr. Brush in *Brush v. Commissioner,* 300 U. S. 352, 57 S. Ct. 495, 81 L. Ed. 691, 108 A. L. R. 1428) had successfully defended an attempt by the Federal Government to collect income taxes he would be forever exempted from income taxes, notwithstanding the subsequent limitation of the rule. A decree that a minimum wage law fixed by state statute for women and children is unconstitutional would, according to appellants, excuse compliance with the law in perpetuity notwithstanding the Supreme Court reversed itself in *West Coast Hotel Co. v. Parrish,* 300

17. In the more recent case of *Graves v. People of New York, ex rel. O'Keefe,* 306 U. S. 466, 59 S. Ct. 595, 83 L. Ed. (Adv. Op.) 577, an employee of the H. O. L. C. was held subject to state income tax and former decisions are overruled.

U. S. 379, 57 S. Ct. 578, 81 L. Ed. 703. Innumerable other examples might be cited not only in the instances noted by Mr. Justice Brandeis, *supra*, but in many other cases decided in recent years where the Supreme Court has changed the law on constitutional matters relating to all manner of property rights.

3. There is still another answer to the claim of *res judicata*. The clear effect of subdivision (h) of Section 83 is to provide: that judgments of dismissal based on old section 80 shall not be *res judicata* under the new law. That is the plain intent of the language used. There is no reason why Congress in a bankruptcy proceeding cannot define the effect to be given to a former judgment in bankruptcy. In doing so it is merely prescribing procedure in the bankruptcy court, with respect to which, as has been pointed out, its power is plenary.

ANSWER TO TENTH PROPOSITION: "CHAPTER IX OF THE BANKRUPTCY ACT IS VOID AS APPLIED TO APPELLANTS".

(a) As Here Applied the Bankruptcy Act Does Not Prefer Junior Liens to Senior Liens or Discriminate Among Liens of Equal Rank.

The Act provides for the approval of a plan for the composition of debts of the taxing agency.

Because *some* of the lands in the District are subject to mortgages or bonds of other independent and distinct public agencies it is claimed the effect of this proceeding is to prefer junior liens and to discriminate among claims of equal rank; and further, that Chapter IX is not a law "on the subject of bankruptcies" (App. Brief, p. 104).

Here again appellants fly squarely in the teeth not only of the *Bekins* case, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137, which held the contrary, but of the *Ashton* case, 298 U. S. 513, 56 S. Ct. 892, 80 L. Ed. 1309, which assumed that the law was adequately related to the "subject of bankruptcies". Furthermore, the points of appellants on this and kindred issues were unsuccessfully raised in the briefs in the *Bekins* case and in *Luehrmann v. Drainage Dist. No. 7,* 104 F. (2d) 696, reviewed *supra,* pp. 54 et seq.

But it is not true that Chapter IX prefers junior liens to senior liens or discriminates among liens of equal rank. The obligations of mortgages or bonds of overlapping agencies are simply not affected by the plan.

The most that can be said in support of appellants' position is, that if the obligations of the Merced Irrigation District are scaled down it leaves more money in the pocket of the taxpayer to pay other obligations. But this has no bearing upon the validity of the law or its application.

The argument of appellants reduces itself to the absurd. They say the Merced Irrigation District cannot compose its own debts (obviously it has no authority to compose mortgage debts or the debts of independent agencies) because the effect is to scale down the obligation of the taxpayer and he therefore has greater ability to pay assessments of other public agencies. These agencies, improvement districts, school districts, etc. must then be brought in and declared bankrupt and that leaves the landowner with more money to pay on his mortgage and it follows that all mortgagees must be summoned. So the obligations of the mortgagees are scaled down and the

man is left with more money to pay the butcher, the baker and the candlestick maker and they too must come to court. So what appellants really are arguing is that you cannot scale down the obligations of the Merced Irrigation District without declaring all the inhabitants in the county bankrupt and adjusting all debts of a public and private nature.

Judge McCormick in his opinion in this case below, 25 Fed. Supp. 981, page 988, gives further reasons why appellants fail on the evidence and the facts relating to the overlapping liens. He points out that the aggregate amount of all other outstanding bonds so far as can be ascertained from the evidence is

> "relatively so small" and the "land within the district affected by such other outstanding bonds is so ununiform in relation to the area covered by the outstanding bonds of the district as to make it impracticable and inadvisable to require that such other obligations be taken into account in this proceeding * * *" He further points out that if the "collateral debts" must be considered and adjusted, the "delay and difficulties" will "destroy the efficacy" of the Act.

Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931, relied on by appellants, contains nothing in conflict herewith; nor does the more recent decision of *Case v. Los Angeles Products Co.* discussed *supra,* pp. 55 et seq.

(b) The California Statute Consenting to This Proceeding (Chap. 72, Cal. Stats. 1939) is Valid. It Does Not Impair the Obligation of Contract. It Merely Gives State Consent to This Proceeding.

The Supreme Court did *not* hold in the *Bekins* case, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137, as appellants say, that Sections 81-84 of the Bankruptcy Act could not be applied "unless the State in question has consented". It said (82 L. Ed. 1142),

> "It is unnecessary to consider the question whether Chapter X would be valid as applied to the irrigation district in the absence of the consent by the state which created it, for the state has given its consent."

Passing this, however, it is manifest that the *Bekins* case is direct authority that the mere *consent* of the state does not impair the obligation of the contract because the decision is predicated upon the assumption that the state *cannot* impair the obligation of the contract and if the *consent* by the state was "impairment", the decision would necessarily have been the other way. Aside from this, however, all the state does in consenting is to waive the privilege which it might have of objecting. As pointed out by Mr. Justice Cardozo in his dissenting opinion in the *Ashton* case, 298 U. S. 513, 56 S. Ct. 892, 80 L. Ed. 1309, at page 1320:

> "Any interference by the states is remote and indirect."

(c) The State Does Not Surrender Its Sovereign Powers by Consenting.

Appellants advance the strange doctrine that by consenting to this proceeding the state surrenders its sovereignty. The *Bekins* case directly holds the contrary:

> "It is of the essence of sovereignty to be able to make contracts and give consents bearing upon the exertion of governmental power." (82 L. Ed. p. 1144.)

As pointed out in detail by Mr. Chief Justice Hughes, the giving of consent by a state is not the surrender of sovereignty but the exercise of sovereignty.

The judgment should be affirmed.

Dated, Sacramento, California,
November 27, 1939.

Respectfully submitted,
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(Appendices A and B Follow.)

Appendices A and B.

Appendix A

EXCERPT FROM U. S. DEPT. OF AGRICULTURE REPORT.

Year and month	Index of prices received by farmers [August 1909—July 1914=100]								Ratio of prices received to prices paid
	Grains	Cotton and cotton-seed	Fruits	Truck crops	Meat animals	Dairy products	Chickens and eggs	All groups	
1920	232	248	191	.....	174	198	223	211	105
1921	112	101	157	.....	109	156	162	125	82
1922	106	156	174	.....	114	143	141	132	89
1923	113	216	137	.....	107	159	146	142	93
1924	129	212	125	150	110	149	149	143	94
1925	157	177	172	153	140	153	163	156	99
1926	131	122	138	143	147	152	159	145	94
1927	128	128	144	121	140	155	144	139	91
1928	130	152	176	159	151	158	153	149	96
1929	120	144	141	149	156	157	162	146	95
1930	100	102	162	140	133	137	129	126	87
1931	63	63	98	117	92	108	100	87	70
1932	44	47	82	102	63	83	82	65	61
1933	62	64	74	105	60	82	75	70	64
1934	93	99	100	103	68	95	89	90	73
1935	103	101	91	125	118	108	117	108	86
1936	108	100	100	111	121	119	115	114	92
1937	126	95	122	123	132	124	111	121	93
November	85	65	88	124	120	132	135	107	84
December	86	64	76	112	111	136	127	104	83
1938—January	91	66	70	101	110	128	113	102	81
February	89	68	68	121	110	121	94	97	77
March	85	70	69	107	117	117	93	96	77
April	82	71	68	117	114	110	93	94	75
May	79	71	77	99	111	103	98	92	74
June	77	68	73	99	116	98	99	92	74
July	72	71	79	115	123	101	103	95	77
August	62	69	78	91	115	102	105	92	75
September	63	69	75	98	117	104	118	95	79
October	60	72	70	108	111	107	124	95	[5]79
November	60	73	71	98	111	109	131	94	[5]78

[5] Preliminary.

Appendix B

PREAMBLE, CHAPTER 24 STATUTES OF CALIF. 1937.

Sec. 1. "The Legislature of the State of California does hereby find, determine and declare to exist a State emergency affecting the peace, health, safety and comfort of the people, caused by and resulting from the inability of irrigation districts formed, organized and existing under the laws of this State to consummate and complete plans for liquidating, refinancing or readjusting indebtedness of such districts, and that such emergency arises out of the following facts, to wit:

That many of such districts were organized during a rapid period of expansion and inflated values and that they issued bonds in excess of their capacity to pay. That during the period of world-wide depression many of these districts became increasingly unable to meet the obligations of their bonded indebtedness, including the payment of interest thereon, and that mounting defaults in such districts with consequent pyramiding of assessments to the point of confiscation, ever increasing delinquencies and inability to sell lands foreclosed by the districts caused a condition of chaos to exist which resulted in the enactment of Chapter 60 of the Statutes of 1933 and Chapter 36 of Statutes of 1935, commonly known as 'Section 11 of the Districts Securities Commission Act'. That this act authorized, subject to the provisions thereof, the levy of assessments during the period of the emergency thereby declared to exist, based upon the ability of the land to pay and contemplated that, with such relief, ordinary economic processes would permit such districts to rehabili-

tate themselves through enabling them and the bondholders in agreement to work out refinancing plans before all values within such districts should be destroyed. That after the passage of said acts districts levied assessments based on the ability of lands to pay, and commenced proceedings to work out refinancing plans with their respective bondholders. That in many of such districts refinancing plans have heretofore been accepted by an overwhelming majority of the bondholders and proceedings have been brought under section 80 of the Bankruptcy Act of the United States to compel acceptance of such refinancing plans by small minority groups of dissenting bondholders. That recently the Supreme Court of the United States has held that such section of the Bankruptcy Act is unconstitutional in that it infringes upon the sovereignty of the States. That as a result of this decision there is now no legal procedure by which refinancing of the present bonded indebtedness of such districts may practicably be consummated. That the excessive debt burden of such districts has so increased and pyramided during the last three years, due to the inability to meet the annual debt obligations, that any present attempt to levy assessments designed to meet such obligations of such districts in full would result in overwhelming delinquencies, would prove largely uncollectible, would raise no adequate funds for bond or other debt service, and would be of no benefit to bondholders or creditors. That, unless these existing chaotic conditions are remedied, in each succeeding year an ever increasing body of lands will default in payment of assessments and will remain unredeemed therefrom. That annual assessments in each succeeding year will fall

upon a progressively lessening body of land which in turn will be forced to default in greater and greater quantities. That such inevitable and wholesale conditions of default will destroy the ability of such districts to pay their bonded debts in whole or in part and to carry out the necessary public functions with which they are entrusted as governmental agencies of the State. That on the contrary if refinancing plans now under way and accepted by overwhelming majorities of the bondholders of such districts can be effected, bondholders and creditors will be benefited, land in the districts will remain in private ownership, values will be restored and such districts will be enabled to discharge their public obligations. That the adequate credit, support and maintenance of such districts as governmental agencies of the State is a matter of vital State interest and concern; that the welfare of the State, the solvency of its banking institutions and the interests of the property owners in, and the creditors of, such districts, all require the speedy settlement and adjustment of the debt defaults of all such districts so that the financial standing, credit and tax collecting ability thereof may be restored * * *''

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District and Reconstruction Finance Corporation,

Appellees.

REPLY BRIEF OF APPELLANT, MINNIE RIGBY, ET AL.

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Pernau-Walsh Printing Co., San Francisco

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Appellants,

vs.

MERCED IRRIGATION DISTRICT and RECONSTRUCTION FINANCE CORPORATION,

Appellees.

REPLY BRIEF OF APPELLANT, MINNIE RIGBY, ET AL.

Pursuant to special permission appellants, Minnie Rigby and Richard tum Suden, as executrix and executor of the estate of William A. Lieber, deceased, herewith submit a reply directed to and in traverse of the statement in appellee's brief wherein it minimizes consideration of the legal effect of the several late decisions of the Supreme Court of the State of California.

It is the purpose of this brief to present for the Court's convenience the importance of those decisions by quotations therefrom.

Responding to the statement in appellee's brief (p. 84), where it is said: "The late California decisions do not purport to state any new rule", it is respectfully urged and submitted that the Court did firmly establish several fundamental rules, subsequent to the Bekins opinion (304 U. S. 27), in which it held for the first time positively that Irrigation Districts are Agencies of the State "whose functions are considered *exclusively governmental.*"

Also the State Supreme Court held subsequent to the Bekins opinion, that the District's power of taxation, right to impose charges for water and electric energy, and that all of its properties, duties, rights and revenues constitute an irrevocable "Public Trust". Also that the full rental value of land within the District boundaries, both urban and rural, constitutes a part of this "Public Trust". Also that the Statute does not begin to run against any presented bond or coupon, until the money necessary to pay has been collected, and notice given. Also that all property, both real and personal owned by the District, no matter how acquired or used, is State owned, and therefor exempt from taxation by a County, and it is also exempt from execution by any creditor.

The *U. S. v. Bekins* opinion (supra) came down on April 23, 1938.

On November 28, 1938, the California Supreme Court determined for the first time in *El Camino Irr. Dist. v. El Camino Land Corp.,* 12 Cal. (2d) 378 at 383, as follows:

"Defendant has attempted to lump together all public bodies and agencies, and to make the characterization of governmental or proprietary use applicable to all. But the cases make a sharp distinction between municipal corporations, such as the cities in the Kubach Co. and Marin Water and Power Co. cases, and *state agencies such as irrigation* or reclamation districts. These latter are agencies of the state whose functions are considered *exclusively governmental;* their property is *state owned,* held *only for governmental purposes;* they own no land in the proprietary sense, within the rule of defendant's cases. (Citing cases.) Once it is established that the property is *owned by the state* or its agency, rather than by a municipal corporation, the rule of the Kubach Co. case becomes inapplicable." (Emphasis ours.)

Also on November 28, 1938, the Court ruled in the case of *Provident Irr. Dist. v. Zumwalt,* 12 Cal. (2d) 365 at 375 as follows:

"But laying aside quibbles as to the exact meaning of the phrase 'uses and purposes', it seems clear that to function on borrowed money, repayment of the money is not a wholly immaterial and foreign objective. Evading creditors is not a contemplated activity of a public district, whose bonds are recognized investments for financial institutions. Among other purposes of the act, therefore is the repayment of the bondholders of the district, and it follows that this is one of the purposes for which the *trust money* is held.

This view is fortified by a consideration of the general plan of the statute, in so far as it pro-

vides for the creation of an obligation and a procedure for payment. The land is the ultimate and only source of payment of the bond. *It can never be permanently released from the obligation* of the bonds until they are paid. The release from liability for assessments while the district holds title is intended to be temporary only, and the liability for new assessments is again imposed when it goes back into private ownership. *Any practice* which removes the land as ultimate security for the bonds, or which places its proceeds beyond the reach of the bondholders, destroys that plan and is contrary to the spirit of the act. And the practice employed by the district herein does exactly that. Theoretically and formally the remedies of the bondholders remain unaltered. Actually they have been destroyed. Economic conditions have placed the land outside of the power of assessment for payment of the bonds. But it is the act of the directors alone which has taken the *proceeds* of the land from the bondholders. This use of the funds, contrary to the whole intent of the act, is in our opinion in violation of the *trust impressed on the land* under Section 29. * * * We assume, for the purposes of this case, that the directors, in their discretion, may determine that some of the proceeds of *leasing* of lands are essential to operation and maintenance, and may use them for these purposes. But any surplus, over and above operating expenses, *remains subject to the trust,* and should go to the payment of bondholders." (Emphasis ours.)

Also on November 28, 1938, the California Supreme Court said in *Moody v. Provident Irr. Dist.,* 12 Cal. (2d) 389 at 395:

"That the annual assessments and the sale of the lands upon which the assessments are not paid may never realize sufficient money to pay the indebtedness of the district is entirely beside the question. The property of the district, so far as it owns any property, constitutes *a public trust* and is held by the district for *a public use,* and, therefore, is *not subject* to levy and sale upon *execution* by a creditor of the district. (Citing cases.) That the *statute of limitations,* under the circumstances disclosed by this case, could *never* be pleaded by the district until it had the money in its possession to pay the bonds belonging to plaintiff, and had given notice, is supported by the case of Freehill v. Chamberlain, 65 Cal. 603, 4 Pac. 646 * * *." (Emphasis ours.)

Other important points of law were clarified and determined, the same day in the case of *Clough v. Compton-Delevan Irr. Dist.,* 12 Cal. (2d) 385, where the Court held the trust is not subject to partition by a creditor.

Shortly after these cases, the Court ruled in *Anderson-Cottonwood Irr. Dist. v. Klukkert,* 13 Cal. (2d) 191, that no land owned or held by Irrigation Districts is subject to taxation by a County. On the same date, it was held in *Glenn-Colusa Irr. Dist. v. Ohrt,* 31 C. A. (2d) 618, that grain owned by an Irrigation District, received in lieu of cash rent for the right to cultivate district owned land (acquired for uncollected assessments), is not taxable by a County.

In the light of these sweeping decisions, all of which came down after the Bekins opinion, and ac-

cording to the rules determined in the *Erie R. R. Co. v. Tompkins,* 304 U. S. 64, and in *C. M. & St. P. & P. R. Co. v. Risty,* 276 U. S. 567, where the Court said:

> "Since our decision in Risty v. C. R. I. & P. R. Co., supra, the Supreme Court of South Dakota in State v. Risty, ... S. D. ....., 213 N. W. 952, has had occasion to pass upon the construction and constitutionality of the South Dakota Drainage statutes, taking a different view from that of this court and the lower courts. * * * *This construction* of the state statutes by the highest court of the state, *we, of course, accept.*" (Emphasis ours.)

there can, we respectfully submit, exist no power whatever under the Constitution to directly or indirectly subject the taxing and borrowing powers of such a State Governmental Agency, or its public bonds, either with or without the *ex-post facto consent* of a State and some creditors, to the bankruptcy powers of the Congress.

Furthermore, Section 83(i) explicitly exempts these powers from the Act. There was no power or authority, either express or implied in the State law, under which these bonds were issued to render them subject to bankruptcy, insolvency or re-organization, whether under State or Federal authority.

We find nothing in the Ashton majority or minority opinions, nor in *U. S. v. Bekins,* which suggests that the taxing or borrowing powers of a State or its Governmental Agencies are subject to the bankruptcy clause.

The revenues which Merced Irrigation District is authorized and directed by State law to collect, by methods other than the levy of unlimited annual ad valorem taxes or assessments against all land, both urban and rural within its boundaries (exclusive of improvements), include charges for water (both domestic and agricultural), electric energy, and the rent for district owned land, all of which relieve the State of the necessity of levying direct taxes for these State owned public improvements, for which the State called the agency into existence, and all of which funds, in excess of operation and maintenance expenses, are declared a "Public Trust", and irrevocably pledged to pay the bonds of appellants.

Stearns v. Minnesota, 179 U. S. 223;
Moody v. Prov. Irr. Dist., 96 Cal. Dec. 512.

Under the construction and application of Section 81 submitted by appellee, the "Public Trust", irrepealably created by the State, for the uses and purposes of the Irrigation District Act (one of which is the payment of money borrowed) may be taken from appellants, and appropriated for the enrichment of private collectors of rent, and for the benefit of tax units, whose taxable resources overlap in whole or in part the same territory, but who can not now tax any property of the Irrigation District, including land or personal property acquired by it for unpaid taxes.

Mr. Robert H. Jackson in his brief for the United States in the *U. S. v. Bekins* case, supra, at page 67 said:

> "The taxing agency, of course, is subject to the full control of the State, and its powers are *only*

those granted by the State. Unless these powers, expressly or by implication, include authority to compose its debts and to invoke the jurisdiction of the bankruptcy court, the taxing agency can not seek the benefit of the Act of August 16, 1937. Not only, therefore, is the choice of the taxing agency wholly voluntary, but it must necessarily be made subject to the provisions of the State law."

At page 83, Mr. Jackson also said:

"But in the case at bar the Lindsay-Strathmore Irrigation District is *not* a 'Political subdivision' of the State of California, and Chapter X is carefully constructed *to permit a separable operation."* (Emphasis ours.)

The relationship of "Public Trust" between this State Governmental agency, and its bondholders, taxpayers, land, water and power users are, in the light of these late California decisions, supra, such as to make Merced Irrigation District wholly outside the bankruptcy power, without impinging both on the reserved taxing and borrowing powers of the State. These bonds are recognized by the Treasury Department as wholly exempt from Federal Income tax.

In *U. S. v. Butler,* 297 U. S. 1, 68, the Court said:

"It is an established principle that the attainment of a prohibited end may not be accomplished under the pretext of the exertion of powers which were granted."

The doctrine of immunity on which the *Brush v. Commissioner,* 300 U. S. 352, rests, has not, we believe, been set aside by any later decision.

We need not enlarge upon the gravity of a subject, touching as directly the dual form of our Government, and the effect on credit, decided one way or the other when an attempt to repudiate such public obligations as are here before the Court, are sanctioned. The framers of our Constitution surely never intended that the power to decide such a question, for the States, with or without consent, is granted to the Congress.

In *Postal Tel. Co. v. Adams,* 155 U. S. 698, the Court said:

> "The substance, and not the shadow, determines the validity of the exercise of the power."

Without repeating arguments already made and authorities cited and other points raised in the briefs of other appellants, may we respectfully suggest that, after all, the main consideration is, in the light of the late California decisions, the total lack of power.

Therefore, we respectfully submit for these and the reasons discussed in the briefs of other appellants, the judgment of the Court below should be reversed, with directions to dismiss the proceeding.

Dated, San Francisco,
December 15, 1939.

Respectfully submitted,
PETER TUM SUDEN,
Attorney for Appellant,
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REPLY BRIEF FOR APPELLANTS.

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REPLY BRIEF FOR APPELLANTS.

INTRODUCTION.

Since appellee has done so, we here repeat, so far as feasible, the headings in our opening brief, following each heading with such comment as is called for by the brief of appellee.

FIRST PROPOSITION: THE RECONSTRUCTION FINANCE CORPORATION IS NOT A CREDITOR AFFECTED BY THE PLAN OF COMPOSITION, AND ITS CONSENT IS NOT ENTITLED TO BE CONSIDERED.

On this point, appellee first says in its brief (pp. 19, 20):

Italics are ours throughout unless otherwise noted.

"A. The Court found the Bonds are Owned by the RFC and are Outstanding. The Issue is Primarily One of Fact, Not of Law."

"B. The Evidence Sustains the Finding."

Appellee's discussion suggests that there are questions of weight and credibility. In fact, there are none. The evidence concerning the relation between RFC and the petitioner is all documentary, and all undisputed. See our brief, pages 10-24. See, also, the brief of Florence Moore, pages 20-26.

Findings in bankruptcy cases are not binding on appeal, especially where based on documentary evidence, or on inferences from undisputed facts: 6 *Cyc. Fed. Proc.,* Sec. 2989; p. 628, ff; 8 *Remington on Bankruptcy,* p. 233.

1. The documents uniformly speak of the transaction as a loan.

Appellee does not dispute the indisputable fact that throughout the documents constituting the contract between the RFC and petitioner, the RFC's advances are spoken of as a "loan", and the petitioner as the "borrower".

2. The RFC and district have repeatedly acknowledged that the indebtedness of the district to the RFC is the loan, and not the old bonds.

The measure of appellee's answer to this proposition is furnished by the following quotation from its Brief:

"In some of the letters or documents written by employees of the RFC the old bonds are loosely referred to as 'collateral' or 'security' and the money used to buy old bonds as an 'advance'.

But of course it is of no consequence what phraseology employees or third persons may use in attempting to describe this rather complicated transaction" (Br. Appellee, p. 24).

To the material in our brief (pp. 20-22), we add only the following: A resolution of the *Board of Directors* of petitioner reads in part as follows (R. 377-8):

> "Upon motion of Director Wood, seconded by Director Wolfe, all bills presented were approved and * * * warrant No. 35,288 in favor of the Federal Reserve Bank of San Francisco, *being for interest on money loaned by the Reconstruction Finance Corporation* for the period July 1, 1936 to January 1, 1937, in the sum of $151,889.71 was *ordered paid out of the refunding bond interest fund.*"

3. The fact that the district, with its own funds, participated in payments to bondholders and paid refinancing expenses further shows there is no obligation of the district to the Reconstruction Finance Corporation on the deposited bonds.

Appellee's attempt to meet the proposition stated in the heading appears at its brief, page 39. In answer, we refer to the authorities cited in the brief of Florence Moore (p. 25), which shows the importance of the proposition stated in the heading.

4. The setting up of reserve funds for the RFC also shows a loan arrangement.

Nothing need be added to our brief (p. 23). See also the brief of Florence Moore, pages 24-25.

5. The RFC is not entitled to be recognized as a creditor because it has not filed a claim.

Appellee treats this point at pages 39-40 of its brief. It does not meet the simple fact that the RFC filed no claim. The statute, we submit, forbids taking account of the acceptance of the plan by any creditor who does not file a claim.

The point is developed in our brief, pages 24-25. It is a highly significant fact that the RFC has studiously remained out of this entire proceeding, except for the filing

of its consent to the plan. Even its consent is significantly ambiguous; it does not mention the debt actually owing to it, namely, the loan; it simply recites that the RFC "has purchased and now holds bonds aggregating in principal amount $14,686,000." This statement is perfectly consistent with what (we submit) is clearly the real status of the RFC, namely, that of pledgee.

Pursuant to the statute, on motion of the objecting bondholders, the RFC was directed by the Court to appear at a hearing set to determine whether it is a creditor affected by the plan (R. 139-140). The RFC did not appear.

6. The transaction resulted in a pledge.

We have shown that under California law (which expressly governs, R. 216), the transaction was a pledge of the old bonds and not a purchase thereof by the RFC (our brief, pp. 25-31; brief of Florence Moore, pp. 23-26).

7. The RFC is fully bound to accept refunding bonds.

The fundamental purpose of the "Bond Purchase Contract" (so entitled) was to provide for the purchase of bonds, i. e., refunding bonds. Its central provision reads:

> "* * * the Borrower will issue and sell, and RFC will purchase, not to exceed EIGHT MILLION SIX HUNDRED THOUSAND ($8,600,000) DOLLARS aggregate principal amount of the refunding bonds of the Borrower * * *".

As we have seen, no word in the contract, nor, indeed, in the superseded "agreement", makes the obligation of the RFC to accept refunding bonds conditional upon surrender of all the old bonds by the nonconsenting bondholders.

We cannot set out the documents in full, but a reading thereof shows that by the Bond Purchase Contract, the RFC became bound to purchase refunding bonds in the

maximum amount above-named, and to surrender old bonds in exchange therefor at 51.501 cents on the dollar.

The appellee quotes (in part) a *proviso* in this contract, to the effect that the RFC may, "in its discretion, keep any part of" the old bonds alive, "for any purpose" (Br. Appellee, p. 23).

Appellee thus says in effect that the parties, by their ultimate contract, meant one of two things (but does not clearly say which):

1. "In consideration of the 'loan' of so much, the 'Borrower' agrees to pay either the amount borrowed or approximately twice that amount, as the lender may elect", or

2. "As between ourselves, the RFC must accept refunding bonds in the amount loaned; but as against any holder of old bonds who refuses to surrender them, the parties hereto may assert that the full amount of the old bonds surrendered are an actual debt of the borrower to the RFC."

Neither of these constructions is tenable, for a number of reasons:

1. Both would be illegal, and void for the excess over the actual debt, under the California law, which governs by express provision (Exhibit OO, p. 216). See our brief, pages 25-31, and the brief of Florence Moore, pages 22-26.

2. Both would be grossly usurious, and void for the excess as a penalty. *Cal. Const.,* Art. XX, Sec. 22; 3 *Williston on Contracts* (2d Ed.), Sec. 781; 5 id., Sec. 1407.

3. The second construction would be contrary to the plain language of the contract. This, because there is *not even a suggestion* that the RFC's alleged option to demand double payment shall cease if all of the old bonds are brought in. On the contrary, the RFC's apparent discretion is absolute. Indeed, the clause says so; it says that

if in any way the RFC should "acquire legal title to *all, or any part*" of the old bonds, then "in its discretion" the RFC may keep the old bonds alive "for any purpose" (Exhibit OO, p. 203).

In other words, if the provision in question is taken to give the RFC the right, at its election, to demand full payment of the old bonds, then inescapably the RFC has that power *in any event,* i. e., whether all of the old bonds are surrendered or not. It follows that the second of the two possible constructions for which appellee contends is contradicted by the contract itself.

4. But the first possible construction (set out above), is, in addition to being illegal under California law, simply fantastic, and contrary to common sense.

It is highly significant, therefore, that an alternate and entirely reasonable interpretation of the provision is possible, namely, this:

The parties intended, we submit, to provide by this provision that the RFC's *security rights* in the old bonds shall include the full rights of an owner, up to, and as security for, the amount owing. Although the RFC would probably have those rights as pledgee without express provision, an express provision is nevertheless both natural and desirable, as is shown by the large amount of litigation that arises, in cases of partial refinancing, over this precise question, namely, the question whether one who has made a loan to a debtor on the security of part of an old bond issue may assert, *as security for the loan* the rights of an outright owner of old bonds. See the many cases on the question discussed in 47 *Harvard Law Review,* 1093-1126, and 81 A. L. R. 139-146.

At page 22 of its brief, appellee says:

> "Under this agreement the district agrees to bring about the participation of all the *old* securities in the refinancing plan (Ex. OO, 218)."

Two comments are appropriate:

1. When examined, the actual provision to which appellee refers in this statement is simply an undertaking by the district to *attempt* to bring about the participation of nonconsenting bondholders. Actual participation by nonconsenting bondholders is *not* made a condition, either in form or substance. It does not, therefore, change the pledge to a conditional purchase.

2. The "Agreement" relied upon by appellee was, we submit, superseded and extinguished long before the first disbursement, as we now show.

The contractual documents were as follows:

1. The original RFC resolution (Nov. 14, 1934) (Ex. OO, pp. 155-79);

2. Acceptance thereof by petitioner (Dec. 11, 1934) (Ex. OO, pp. 180-2);

3. An amendment of the RFC resolution (July 6, 1935) (Ex. OO, pp. 192-3);

4. Acceptance thereof by petitioner (July 23, 1935) (Ex. OO, pp. 194-7);

5. An "Agreement" between RFC and the petitioner (Aug. 14, 1935) (Ex. OO, pp. 217-21);

6. The "Bond Purchase Contract" (Sept. 16, 1935) (Ex. OO, pp. 202-17);

7. A second amendment to the original RFC resolution (about Sept. 17, 1935) (Ex. OO, pp. 193-4);

8. Acceptance thereof by petitioner (Sept. 18, 1935) (Ex. OO, pp. 198-201).

The first disbursement by the RFC was on October 4, 1934, when $14,071,000 of old bonds were surrendered (R. 344).

The "Bond Purchase Contract" of September 16, 1935 (number 6, supra), incorporates by reference the original resolution of the RFC and the resolution of petitioner accepting it, i. e., numbers 1 and 2, supra (Ex. OO, p. 213, foot). The "Bond Purchase Contract" also provides as follows (Ex. OO, p. 216):

> "This contract, together with the Resolution of R.F.C. herein referred to, and also the resolution of the Borrower, herein referred to, *contain the entire agreement between the parties* and shall be governed by and construed in accordance with the laws of the State of California."

This provision necessarily, we submit, excludes, and supersedes, the "agreement" of August 14, 1935 (number 5, supra), cited several times and quoted at length by appellee, at pages 22-23, and elsewhere.

Apart from that circumstance, however, as shown above, the "agreement" does not support appellee's statement.

Nowhere in the final contract, i. e., the resolutions referred to and the Bond Purchase Contract, is there so much as an intimation that all the old bonds must be brought under the plan as a condition to the RFC's obligation to exchange the old bonds held by it for refunding bonds.

We lack space to analyze the contract in detail, and must ask the Court to read the documents, which are listed above in order of execution.

8. The Reconstruction Finance Corporation had no authority in law to do other than make a loan to the district, and the district was authorized only to accept a loan.

The only argument of appellee that requires notice (pp. 40-41), is the statement that the RFC is by the statute authorized to make loans "through the purchase of securities". So it is; but one cannot make a loan to a debtor by purchasing its bonds, unless either (a) the bonds are

purchased directly from the debtor, or (b) the bonds are (as we say is the case here), purchased from third parties *for the account of the debtor,* and held by the lender simply *as security* for the loan.

It follows, as shown in our brief, pages 31-34, that purchase of the old bonds by the RFC on its own account, would have been *ultra vires;* and contracts are not construed as so intended.

9. The plan has been fully executed out of Court as to the deposited securities.

Nothing in appellee's brief requires any addition to the discussion of this point in our brief, pages 35-36.

10. The RFC and the district are bound by the proceeding in the State Court.

Appellee (pp. 41-2) ignores the plain intent of the California statute to provide that voluntary acceptance of a plan is election to make a binding contract, and therefore is irrevocable *in any event,* even though the proceeding is later dismissed, or the statute held void. It follows here that the debt of appellee to the RFC was fixed as the amount of its loan, by its voluntary acts in the State proceeding. This apart from all else in the case.

11. No provision in the statute permits debts that have been extinguished to be treated as still existing.

Appellee argues that even though its actual debt to the RFC is simply the amount of the loan, secured by the surrendered old bonds, even so (it argues), the statute permits it to say, as against appellants, that it owes the full amount of the old bonds. The provisions relied on for this startling proposition are these:

> "Any agency of the United States holding securities acquired pursuant to contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof" (Sec. 82).

> "The partial completion or execution of any plan of composition as outlined in any petition filed under the terms of this Act by the exchange of new evidences of indebtedness under the plan for evidences of indebtedness covered by the plan, whether such partial completion or execution of such plan of composition occurred before or after the filing of said petition, shall not be construed as limiting or prohibiting the effect of this Act, and the written consent of the holders of any securities outstanding as the result of any such partial completion or execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition" (Sec. 83(j)).

The brief of Florence Moore (pp. 26-32), shows that these provisions cannot reasonably be construed as appellee contends.

Appellee argues (p. 28) that since Section 83(j) permits any creditor who has taken refunding bonds to consent, it should apply here because refunding bonds are to be issued in the future. There are two answers: (a) Section 83(j) permits consent of the *refunding bonds*, not of the old bonds cancelled by the issuance thereof; (b) it follows by unavoidable implication, that the Congress had no intention of providing that debts extinguished (as here), by partial but permanent action out of Court, may be revived and treated as still existing later on.

No rational purpose would be accomplished by construing the statute as reviving the cancelled debts for any purpose.

This proposition is discussed in the brief of Florence Moore, pages 32-34, where it is shown that nothing would be added to the already ample powers of the RFC to participate in refinancing schemes, by the astonishing an-

nouncement that the Municipal Bankruptcy Act, as quoted above, has the effect that a petitioner owing $10,000,000 may scale down its debts as if it owed $20,000,000.

It is important to observe that if construed as appellee contends, the statute would fictitiously swell the claims of the RFC (and of all governmental agencies), even in cases where the agency frankly admitted (what the RFC has never denied in this case) that it "held" the old securities merely as pledgee, as security for a much smaller debt. Moreover, it would have that effect in *all* proceedings under the act; not merely as against non-consenting bondholders, but as against all other creditors as well. The outrageous consequences are apparent. Appellee's construction is therefore opposed by the fundamental canons of interpretation.

The provision making public agencies creditors for "full face value" is inapplicable, however construed, under the rule against retrospective interpretation.

The proper construction (as above) is, we submit, that the provisions are intended to settle the much-vexed question of the *security* rights of parties participating in a partial refinancing.

The RFC is not the United States Government, nor are its contracts laws. As the Court said in *Continental Ill. Nat. Bank & Tr. Co. v. Chi., R. I. & Pac. Ry. Co.*, 294 U. S. 648, 684, answering the RFC's claim to a special position in a proceeding under Section 77B:

> "The Reconstruction Finance Corporation Act creates a corporation and vests it with designated powers. Its entire stock is subscribed by the government, but it is nonetheless a corporation, limited by its charter and by the general law. The act does not give it greater rights as to the enforcement of its outstanding credits than are enjoyed by other persons or cor-

> porations in the event of proceedings under the Bankruptcy Act."

So here, except to the extent that the statute so provides (and up to the time of any such enactment), the RFC's rights are simply those of any other creditor lending money on the security of old bonds.

If the statute were construed as petitioner contends, it would be giving it completely retrospective effect to apply it here, i. e., to say that the debt, which had been owing to the RFC for two years at the time of the enactment, shall (as against other creditors), be doubled.

It is settled that every presumption militates against such a construction, and certainly nothing in the statute expresses, or even suggests, intent that it shall operate retrospectively. To our previous discussion (brief of Florence Moore, pp. 34-36), we add the following:

Hassett v. Welch, 303 U. S. 303:

A Federal Estate Tax subjected to taxation all irrevocable transfers made during decedent's lifetime, where he reserved a life interest. The Court here held this inapplicable to transfers made before the enactment, by one who died after the enactment. The Court said:

> "In view of other settled rules of statutory construction, which teach that a law is presumed, in the absence of clear expression to the contrary, to operate prospectively; * * * we feel bound to hold that the Joint Resolution of 1931 and § 803(a) of the Act of 1932 apply only to transfers with reservation of life income made subsequent to the dates of their adoption respectively."

Miller v. United States, 294 U. S. 435:

The Court here held that a regulation of the Veteran's Bureau that the loss of one hand and one eye constitutes total permanent disability, did not apply to a cause of action existing at the date of the regulation, though the

regulation was in force when action was brought. The Court said:

> "The law is well settled that generally a statute cannot be construed to operate retrospectively unless the legislative intention to that effect unequivocally appears. Twenty per Cent. Cases, 20 Wall. 179, 187, 22 L. ed. 339, 341; Chew Heong v. United States, 112 U. S. 536, 559, 28 L. ed. 770, 778, 5 S. Ct. 255; Fullerton-Krueger Lumber Co. v. Northern P. R. Co., 266 U. S. 435, 437, 69 L. ed. 367, 368, 45 S. Ct. 143. * * * Accordingly, the regulation here involved must be taken to operate prospectively only."

12. **Appellee's authorities (in support of its contention that the RFC is a creditor to the full amount of the old bonds held by it), do not support the contention.**

Appellee says (pp. 29-37) that in the past,

> "* * * reorganization agencies found it necessary to acquire outstanding securities and hold them at their full face value so as to assure equality among all holders. A long line of cases upholds such practice."

The fact is, however, that the cases then cited are simply not in point. They fall into three groups:

1. Several of them announce the rule that a corporation may acquire its own bonds and pledge them as security. They do *not* hold, however, or even suggest, that the holder of such bonds is a creditor to the full amount thereof. On the contrary, they hold or assume that bonds so held may be enforced only so far as necessary to pay the debt for which they are security. Thus, in

> *Claflin v. South Carolina R. Co.,* 8 Fed. 118 (cited and quoted by appellee at page 31),

the Court said in part (p. 133):

> "Without pursuing this branch of the case further, it is sufficient to say that I am of the opinion that the holders of all bonds now out on pledge by the company are entitled to their proportionate share of the security of the mortgage, *to the extent that may be neces-*

sary to pay the debts for which they are respectively held."

This case as well as

American Brake Shoe & Foundry Co. v. N. Y. Rys. Co., 270 Fed. 261, also cited by appellee,

is discussed in an excellent article on the question of corporations pledging their own bonds, in 47 *Harvard L. Rev.* 1093, 1103-4, 1106-7, quoted below.

Other cases of the same kind cited by appellee are

Fidelity & Columbia Trust Co. v. Louisville Ry. Co., 258 Ky. 817, 81 S. W. (2d) 896;

Slupsky v. Westinghouse, 78 Fed. (2d) 13.

The article in the *Harvard Law Review* just referred to reads in part as follows, and shows that in such cases the creditor is *never allowed to collect more than the actual debt for which the debtor's bonds are held as security:*

"* * * While the giving of one unsecured obligation of a debtor as collateral security for another unsecured obligation seems an obvious anomaly, yet in the absence of any intervening equities of other creditors, such an arrangement may be of some procedural value, since some courts may permit the creditor to bring suit on the collateral rather than on the principal debt. Although only a single satisfaction *not exceeding the amount of the real debt* is allowed in such cases, the creditor's recovery may be expedited if a sealed instrument or a negotiable note secures an unfunded obligation. It is apparent, however, that to permit a claim to be made in any form of insolvency proceeding both on the principal debt and on the pledged unsecured bonds, or on the pledged collateral alone to an amount exceeding the real debt, will run directly afoul of the elementary proscription against double or padded claims. The courts in these cases where additional unsecured bonds or other evidences of indebtedness of the debtor have been pledged as collateral security have seen clearly the vice in a pledge of a debtor's own obligations, and, apparently without ex-

ception, *have uniformly denied a creditor the right to prove a claim upon any but the real debt.*

If the assets of the corporation are not being administered for the benefit of creditors, the pledgee [of mortgage bonds], as in the case of unsecured collateral may pursue its remedy on the pledged bonds and obtain a personal judgment thereon, subject to satisfaction for *only the amount actually owing.* In the event of insolvency proceedings, however, the only proper basis for a deficiency claim *is the amount owing on the actual debt. A claim against general assets based upon the bonds is improper, either in addition to the claim based upon the actual debt or even as an alternative thereto.*

Where a creditor's day of reckoning with a corporation calls for the liquidation of a debt secured by the corporation's own mortgage bonds, the unraveling of the pledgee's rights is not essentially complicated if the vital differentiation between the promissory element of the bonds and the element of the property lien is observed. Undoubtedly, of course, the bonds afford a form of security so far as the proceeds of the mortgaged property are applicable. *But they cannot serve to enlarge beyond the amount of actual indebtedness the basis for the computation of dividends from the general assets.''*

2. Appellee also cites the following cases on this question:

Mowry v. Farmers' Loan & Tr. Co., 76 Fed. 38;
Barry v. Mo. K. & T. Railway Company, 34 Fed. 829, at p. 832;
Ketchum v. Duncan, 96 U. S. 659, 24 L. Ed. 868;
Slupsky v. Westinghouse, 78 Fed. (2d) 13;
Burlington City Loan & T. Co. v. Princeton Lighting Co., 72 N. J. Eq. 891, 67 Atl. 1019 (Nov. 18, 1907).

In fact, these cases announce and apply a wholly irrelevant doctrine, namely this: Where a corporation offers refunding bonds which are not accepted by all of the old

bondholders, and where the old bonds surrendered are not cancelled, but are held as security for the refunding bonds, the holders of the refunding bonds may enforce the lien of the old bonds, on equal terms wtih the non-consenting old bondholders, *so far as and no further than is necessary to satisfy the amount of the refunding bonds.* They hold simply that the *security* behind the old bonds accrues to the benefit of the new bonds.

Three of these five cases are discussed in a note on the question, entitled "Lien of mortgage securing corporate bonds as affected by exchange of bonds for those of reorganized or new corporations" (81 A.L.R. 139). None of these cases even suggests (what appellee contends) that the amount of the old bonds continues as an obligation of the debtor. They hold, on the contrary, that the old bonds survive only as security for the new obligation up to, but not beyond, the amount of the new obligation.

3. One of the cases cited by appellee,

Ketchum v. Duncan, 96 U. S. 659, 24 L. Ed. 868,

concerns still a third situation, not relevant here. In that case the claimant had *not* lent money to the company at all, whether to buy up securities or for any other purpose. He had simply bought up coupons on his own account, to preserve the credit of the company, in which he was interested. The Court said in part:

> "In near prospect of this inability, William B. Duncan, the head of the firm, on the 28th of April, 1874, telegraphed from New York to the company at Mobile that his firm would purchase for their own account sterling coupons, payable in London. The firm also telegraphed to the Bank of Mobile and to the Union Bank of London to purchase the coupons there presented for them, charging their account with the cost, and transmitting the coupons uncanceled. The railroad company acceded to the proposition made

them, and the Bank of Mobile and the Union Bank did also."

The inapplicability of the *Ketchum* case here is brought out strikingly by the fact that the Court approved, but *distinguished* a New York case which *is* in point in the present controversy, namely,

Union Tr. Co. of N. Y. v. Monticello & Port Jer. R.R. Co., 63 N. Y. 311.

Missouri K. & T. R. Co. v. Union Trust Co., 156 N. Y. 592, 51 N. E. 309, held (concerning an issue of bonds a small part of which was callable each year by lot) that the debtor, which had itself acquired most of the bonds, could not call the remainder immediately, but was bound to follow the method for calling bonds provided therein. Neither the decision nor the opinion has any bearing here.

At the end of this part of its brief, appellee makes the following statement:

"* * * what the Barry case held in effect was that * * * the dissenting bondholders here are required to establish their rights on the basis of a $16,000,000 bond issue."

But as just shown, the *Barry* case does not hold any such thing; indeed it assumes the exact opposite.

SECOND PROPOSITION: PETITIONER IS BARRED FROM OBTAINING A CONFIRMATION OF ITS PROPOSED PLAN BECAUSE OF ITS LACK OF GOOD FAITH AND CONSTRUCTIVE FRAUD.

Appellee suggests that the requirement of good faith is (as against appellee) merely a requirement that the plan be feasible. The numerous authorities under Section 77B are to the contrary (Our Br. pp. 38-41). The require-

ment of good faith appears in substantially the identical context in Section 77B and in the statute here involved.

When the government or a governmental agency seeks relief from a Court, it is subject to the same rules as private litigants.

Luckenback S. S. Co. v. The Thelka, 266 U. S. 328.

Petitioner diverted $717,932.50 of trust funds.

Appellee says that all the money diverted has been accounted for. It is no answer to a charge of diversion of trust funds that the unauthorized uses are shown.

Appellee asserts that sufficient funds are now again in the treasury of the district to satisfy the claims to diverted trust funds (p. 45). The diversion by appellee of the trust funds, the intent that such diversion shall be permanent, and the effect of hindering, delaying and defrauding creditors, are clear from the undisputed evidence (Our Br. p. 45).

Appellee asserts that all the money collected and not spent for necessary *"operations"* is now in the treasury to be placed where the Court orders (Br. p. 45). This is not true. There was spent by the district, during the period 1933 to 1937, inclusive, for *capital betterments, alone,* $321,601.52;* in capital payments (R. 515), on Crocker-Huffman contracts for the purchase of water rights, $299,049.34 (R. 847, 853, 864, 874, 882); irrigation district bond *principal,* $59,000**; *principal* payments on drainage bonds, $61,200 (R. 848, 854, 865, 874, 883); refinancing expenses (*exclusive* of interest paid depositing bondholders), $284,430.82 (R. 847, 854, 865, 875, 882).

*1933, $32,692.42 (R. 847); 1934, $40,933.48 (R. 853); 1935, $52,392.34 (R. 864); 1936, $80,187.85 (R. 874); 1937, $115,395.43 (R. 882).

**1933, $24,500 (R. 848); 1934, $34,500 (R. 854).

A total of *$966,281.68* was thus spent for capital and refinancing expense, which was not operating expense.

Appellee claims that "each year from 1922/23 to 1931/32, inclusive, after *bond service was satisfied,* the balances of the bond fund levy (delinquency collections, etc.)", were placed in the general fund as expressly authorized by law, and that such transfers occurring *prior* to 1933 account for "all but $320,272.93" of the $717,932.50 (App. Br. 45). Appellee thus claims that this money was legally transferred from the bond fund *before 1933* when the bonds were *not* in default.

This is not true. The undisputed testimony of Mr. Neel, auditor for the district, is that the entire amount of $717,932.50 was collected "as a result of the collections of delinquent taxes *that were delinquent as of December 31, 1932*" (R. 414). Thus, the entire amount was collected *after* December 31, 1932, and *after* the bonds of the district were in default, so that the right to transfer had ceased.

Appellee admits the diversion of $320,272.93 of 1932/33 collections (App. Br. p. 45), but gives as its excuse that under the first refunding plan of 1933, *which never went into effect,* it was proposed that this money be transferred for general purposes of the district. It is no excuse for diversion of trust funds to say that the district would have been entitled to the money if an agreement had been made.

Appellee repeatedly states that the granting of the RFC loan raised the price of the bonds from 18 cents to 50 cents (p. 48). This statement is not defensible. The testimony of Mr. Lester (R. 500) referred to in appellant's brief was that the bonds sold at 18 *at the bottom of the depression,* but *had reached 32 in the fall of 1934,* and it was undisputed that there was a bid of 56 for the

bonds February 5, 1935 (R. 521), eight months before the first disbursement under the RFC loan, in October of 1935 (R. 367). The bonds of overlapping tax lien districts, which have no greater security than have the irrigation district bonds, and which were not "refinanced" by the RFC, and upon which principal and interest has been paid (R. 419, 540), such as Merced Union High School District, have recovered with securities generally, so that they are now selling above par (R. 889). The effect of the RFC loan has been to *limit the price of the bonds to 50.* The passing of the panic, and the inherent value in the district would have raised the price well above that figure.

Appellee (p. 48) claims that refusing to levy taxes for six years for bond purposes was pursuant to law. Even Section 11 of the District Securities Act under which the taxes were levied (Our Br., Appendix), requires the levy of a tax calculated to produce a delinquency of 15%. The actual delinquency produced as of the delinquent date for the year 1937-38 was $23,528.48, or 6.84% as of the last Monday in June, and as of November 1, four months later, was reduced to $12,262.39 (R. 668). Delinquency after one year in each of the levies from 1933 to 1937 as of November 1, 1938, average 1⅓%. Therefore (App. Br. pp. 46, 47), petitioner has not, we submit, complied with the law under which such reduced taxes were levied.

The district misrepresented its financial condition.

The primary basis of our discussion of this point was appellee's own balance sheet (Ex. 26).

The term "balance sheet" is defined in The New Merriam-Webster Dictionary as "A statement of the financial condition of an individual or organization at a given date, esp. a statement of assets, liabilities and net worth". This is the only meaning given to the term, either in the dic-

tionary, or in the works on accounting. The testimony of the district's auditor at the trial was that this exhibit purported to be a true statement of the financial condition of the district, assuming that its indebtedness included the whole bond account (R. 425).

Appellee (App. Br. p. 50) states that "*petitioner did not overstate its liabilities*". In support of this statement, while it cannot avoid the undisputed fact that $824,684.00 paid to RFC as interest, and other interest paid or not due, was still kept as a liability of the district on its balance sheet, appellee attempts to excuse itself by the claim that this interest was carried on the books as an "interest expense account *in the nature of a refinancing charge*".

This is no justification, and further, is not true. Mr. Neel testified that this amount was "paid on bond interest expense" or as "an interest expense account" (R. 425). It is shown in the published financial statements of the district for 1936 and 1937 (R. 875, 883) as "Interest Account, Reconstruction Finance Corporation". As we have shown, the district *charged the same interest twice.* It paid it once out of its cash account, *as an operating expense,* and set it up the *second* time as a *fictitious liability,* although it had already been paid. No amount of adroit general statement can avoid the fact.

It is true as to the overstatement in bond principal, that all parties knew the indebtedness was $16,191,000. However, a separate item of $387,000 additional was set up in a *different* place as a *current* liability, where it was not readily perceivable, and, as stated in Mr. Lombard's affidavit, that amount was charged to surplus. In short, a *fictitious deficit was created* by the charge. Since the *question at issue* was as to whether the district had a *surplus* or *deficit,* and how much, and the direct effect of this maneuver was a *fictitious increase of the deficit,* there

can be no question as to the material falsity of the statement in this respect.

Petitioner contends that it did not understate its assets. It claims that if the assessment levy of $340,000 should be included as an asset, estimated expenditures of 1939 should be included in the balance sheet as a liability. The very definition of the term "balance sheet" in the dictionary discloses the fallacy of this statement. A balance sheet contains only assets, liabilities and net worth as of a given date. *It is not a budget* wherein future expenditures and income are included. The $340,000 was a current, collectible, account receivable, secured by a lien on all of the lands in the district, and constituted an asset. Estimated expenditures for the future did not constitute a liability.

Appellee half admits (App. Br. p. 52) as its secretary did in fact admit (R. 515), that the Crocker-Huffman contracts constituted a capital asset which were not shown as assets but were charged off to operating expense.

Appellee denies that it kept books and records on two separate theories of its liabilities to the RFC. It made reports and *balance sheets* to the RFC showing liabilities of $13,000,000 less than the liabilities set forth in Exhibit 26, a *balance sheet* (Ex. J & K, R. 774, 784). Those balance sheets were approved by the RFC, and the district confirmed the RFC auditors' statements as to the amount of the liability to the RFC shown on the district records (Ex. N, R. 797), writing to the RFC "*the above is in agreement with our records* at December 31, 1936, with the following exceptions * * *." The evidence remains undisputed that the district kept one set of records and *a balance sheet* for the RFC, and it introduced in Court *another balance sheet* and set of records, in which its liabilities were set up as *$13,000,000 greater* (App. Br. p. 56).

THIRD PROPOSITION: PETITIONER HEREIN IS NOT "INSOLVENT OR UNABLE TO MEET ITS DEBTS AS THEY MATURE".

See the discussion of this point in our brief (pp. 53-4). Appellee says (p. 54) that even though appellee owes the RFC only $7,570,000, as we contend, then "presumably",

> "the R.F.C. at any time can demand payment of the entire sum * * *"

This is not true. The RFC's rights are stated in the documents, and the right to demand full payment at any time is not among them.

FOURTH PROPOSITION: THE PLAN OF COMPOSITION IS NOT FAIR, EQUITABLE OR FOR THE BEST INTERESTS OF THE CREDITORS; AND IS DISCRIMINATORY.

We first deal with the law concerning what is a fair plan, with particular reference to *Case v. Los Angeles Lumber Products Co.,* supra.

A. THE APPLICABLE RULES OF LAW CONCERNING WHAT IS A FAIR PLAN.

Preliminarily we deal with appellee's discussion of this and another case.

(a) Luehrmann v. Drainage Dist. No. 7, 104 Fed. (2d) 696.

The appellee relies extensively on the *Luehrmann* case just cited in the heading. We therefore discuss the case rather fully.

1. Appellee says (p. 54) that the denial of certiorari in this case is "highly significant". A sufficient answer is the following quotation from

United States v. Carver, 260 U. S. 482, 490:

> "The denial of a writ of certiorari imparts no expression of opinion upon the merits of the case, as the bar has been told many times."

2. Appellee repeatedly (pp. 19, 29, 37) refers to the *Luehrmann* case as authority for its contention that the RFC is a creditor to the full amount of the old bonds.

The fact is that in the *Luehrmann* case it was *not even contended* that the RFC was a creditor beyond the amount of its loan, it being conceded by all concerned that the RFC's right in the old bonds was simply that of a pledgee. There are three opinions: One by the District Court passing on the constitutionality of the second bankruptcy statute (21 Fed. Supp. 798), the District Court's opinion approving the plan (25 Fed. Supp. 372), and the opinion of the Circuit Court of Appeals (104 Fed. (2d) 696). In its first opinion the District Court said,

> "In this particular case, however, *no agency of the government holds the old securities,* but they are in fact held by a trustee who appears to have taken over legal title from the original bondholders, the larger portion of whom transferred the bonds to the trustee through the agency of the Bondholders' Protective Committee" (21 Fed. Supp. 801, 802).

The terms of the trust spoken of by the Court do not appear, but it does appear unequivocally that the trustee, and not the RFC, was owner of the bonds.

The trial Court, in approving the plan, made a finding reading in part as follows:

> "* * * said bonds are held now as collateral to the note of Louis V. Ritter, Trustee, and are voted in favor of the debt readjustment plan * * *" (104 Fed. (2d) 702).

The Circuit Court of Appeals said on this question:

> "* * * *Chapman, holding as trustee 98.2% of such bonds, filed acceptance of the plan* * * *.*
>
> " 'the old outstanding bonds, as well as the judgments purchased from the Cross County claimants are being held by the Federal Reserve Bank in Cleve-

land, *as collateral to the trustee notes.' (Given for the proposed loan and advancements by the Reconstruction Finance Corporation)"* (104 Fed. (2d) 699, 700).

3. In the *Luehrmann* case both the trial Court and the Circuit Court of Appeals relied on the fact that a large proportion of the bondholders had consented, as being evidence of fairness (25 Fed. Supp. 378, 104 Fed. (2d) 703). This, indeed, is conceded by appellee (App. Br. pp. 64-5).

4. Appellee states, at page 91 of its brief:

"The issue of *res judicata* also was apparently involved in *Luehrmann v. Drainage Dist No. 7,* 104 Fed. (2d) 696, and resolved against appellants."

There is no foundation for this statement. It nowhere appears that the issue of *res judicata* was in the case; and indeed it could not have been, for the reason that although a proceeding was brought by the district under the first Municipal Bankruptcy Act, that proceeding was *dismissed by the petitioner district,* after the decision of the *Ashton* case (21 F. Supp. at p. 822).

5. In the *Luehrmann* case it is explicitly held that the District there involved (an Arkansas Drainage District) was not a governmental agency (see 104 F. (2d) at p. 698).

(b) Case v. Los Angeles Lumber Products Co., ... U. S. ..., 60 Sup. Ct. 1.

The obvious importance of the case cited in the heading makes it unnecessary for us to analyze the Court's opinion, since the Court has undoubtedly examined that opinion itself.

The appellee seeks to escape from the *Los Angeles Lumber Products Co.* case by arguing that Section 77B is a reorganization statute and the Municipal Bankruptcy

section a composition statute, and that therefore under the latter section the plan need not be found "fair and equitable" within the settled meaning of those words, established long before they were used in this statute (App. Br. pp. 54-59).

This argument need not detain us long. As is well known, the earlier devices for dealing with insolvent enterprises (without compelling dissolution) were (a) the old composition Section 12 of the Bankruptcy Act, and (b) the procedure developed by the Courts without the aid of statute in equity receivership proceedings. Neither was entirely satisfactory, and the Congress undertook to provide adequate statutory procedure: It enacted Section 77 (for railroads), Section 77B (for private corporations), the first Municipal Bankruptcy provision (Section 80), and thereafter the present provision (Sections 81-84). All are developments from, and combine qualities of, the old composition sections and the judicially developed equity receivership; all are substantially identical in their essential requirements. As stated by *Gerdes on Corporate Reorganization,* Vol. 1, p. 95:

> "Section 77B merely applies *the principles of composition,* modified to meet the problems peculiar to enterprises corporately owned."

See the introductory sections in *Gerdes on Corporate Reorganization,* and in *Finletter, Principles of Corporate Reorganizations.*

The words "fair and equitable" appear in the same context in Sections 77, 77B, the first municipal bankruptcy provision, and the section here involved. The *Los Angeles Lumber Products Co.* case says that they are words of art with a fixed legal meaning. The opinion points out explicitly that the "fair and equitable" standard was not present in, or required by, the old composition section 12.

(c) The proposed plan violates the principle of the Boyd case under any theory of the facts.

The principle now established by

Case v. Los Angeles Lumber Products Company, ... U. S. ....., 60 Sup. Ct. 1,

is summarized in the following quotation by the Court from an earlier opinion:

> "In Louisville Trust Co. v. Louisville, New Albany & Chicago Ry. Co., supra, this Court reaffirmed the 'familiar rule' that 'the stockholder's interest in the property is subordinate to the rights of creditors. First, of secured, and then of unsecured, creditors.' And it went on to say that 'any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.' "

This doctrine, we submit, is no mere rule of thumb. On the contrary it is a simple and obvious principle of common honesty.

It is not to be assumed that the Court will be less solicitous to preserve this principle in administering the municipal bankruptcy sections than it is in administering the corporate reorganization sections.

(d) The principle of the Boyd case has two applications.

There are two applications of the principle that a plan is unfair where its effect is that the subordinate rights of the debtor, or the equitable owners of the debtor, are secured at the expense of the prior rights of creditors:

1. Where the property responsible for the debts is worth less than the amount of the debts, then the creditors must be given the *full value* of the property chargeable with the debts; for if they are not, the plan simply takes

property which belongs to the creditor and gives it to the debtor. The *Los Angeles Products* case holds that this is unfair.

2. Where the assets *exceed* the amount of the debts, then, for the same reason, no plan is fair whereby the creditor is compelled to take less than the amount of his claim. This necessarily follows from the same principle. Thus, in the case of

In re Day & Meyer, Murray & Young, 93 Fed. (2d) 657,

the Court said, in part:

> "Where the value of the mortgaged property is more than the principal amount of the bond indebtedness, there is no justification in reducing the indebtedness to one-half of the principal."
>
> * * * * * * *
>
> "It is the duty of the court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not by indirection diverted to stockholders. In re New York Rys. Corp., 2 Cir. 82 F. 2d 739; In re Barclay Park Corp., supra."

(e) The relation between the petitioner, the land, the landowners, and the debt.

The landowners are the owners of the debtor.

Although the landowners in an irrigation district are not shareholders, they are in substantially the same position as shareholders, being the equitable owners of the debtor. Thus, in *Hall v. Superior Court,* 198 Cal. 373, it was held that certain judges, who were the owners of land in an irrigation district, were disqualified in an action against a private water company for damages caused by seepage of water from a canal, where the irrigation district had a proprietary interest in the canal. The Court said in part:

> *"While not occupying the precise status of stockholders in a corporation, yet the land owners, as members of an irrigation district, sustain such a relation to the district as to give them a proprietary interest in the district's property.* This relation is aptly pointed out in the case of *Merchants' Nat. Bank v. Escondido Irr. Dist.,* 144 Cal. 329, 334 (77 Pac. 937, 939). * * *
>
> "[The statute vests in the landowners] a definite proportion of the water of the district, and in all, in common, the equitable ownership of its water-rights, reservoirs, ditches, and property generally, as the means of supplying water. (Stats. 1887, pp. 34, 35, secs. 11, 13.) *Such rights as these cannot be distinguished in any way from other private rights,* * * *".

See, also:

Hershey v. Cole, 130 Cal. App. 683;

Lindsay-Strathmore Irrigation District v. Wutchumna Water Co., 111 Cal. App. 688.

The land is charged with payment of the debt.

Any number of cases make it clear that these bonds are in practical effect the equivalent of (and indeed superior to), a mortgaging of the lands of the district as security for their payment. Thus, in

Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365, 373-4,

the Court said of irrigation district bonds,

> "In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district. It is true that the bonds themselves are not a lien on the land. But the assessment is a lien (sec. 40), and the district is required to collect the assessment or sell the land."

Again, in

Moody v. Provident Irrigation Dist., 12 Cal. (2d) 389,

the Court quoted and relied on an earlier case concerning municipal bonds, to the effect that they are "equivalent to a trust deed".

The fundamental principle of the Boyd case is the law of California Irrigation Districts.

There is no doubt that the law controlling California irrigation districts includes, in essence, the very principle of the *Boyd* case. Thus, in

Provident Land Corp. v. Zumwalt, supra,

the Court said (12 Cal. (2d) 370, 371, 372, 375-6):

> "The ordinary method of payment of bondholders is clearly indicated by these provisions. The directors must levy assessments in a sufficient amount to meet principal and interest payments."

The Court then referred to the depression of the early '30s, and said:

> "As a result, some districts now own practically all the land within their boundaries, * * * The delinquencies have gone too far in this and other districts to save the landowners. * * * In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district. It is true that the bonds themselves are not a lien on the land. But the assessment is a lien (sec. 40), and the district is required to collect the assessment or sell the land. * * *
>
> Evading creditors is not a contemplated activity of a public district, whose bonds are recognized investments for financial institutions. Among other purposes of the act, therefore, is the repayment of the bondholders of the district, and it follows that this is one of the purposes for which the trust money is held.
>
> This view is fortified by a consideration of the general plan of the statute, in so far as it provides for the creation of an obligation and a procedure for payment. The land is the ultimate and only source of payment of the bonds. * * * Any practice which re-

moves the land from its position as ultimate security for the bonds, or which places its proceeds beyond the reach of the bondholders, destroys that plan and is contrary to the spirit of the act."

The foregoing discussion demonstrates, we submit, that in every essential respect the situation created by the issuance of irrigation district bonds is precisely that contemplated by the principle of the *Boyd* case.

(f) Municipal bankruptcy is a co-operative venture between the State and Federal authorities.

It is important to observe that the second Municipal Bankruptcy Act requires cooperative action by both the Federal Government and the States. As stated at numerous points in the Municipal Bankruptcy Act, the Federal Courts in administering the Act must be careful not to encroach in any way upon the sovereign powers of the states; and under the Bekins decision this is not merely a statutory requirement but a constitutional requirement. The cooperative nature of municipal bankruptcy is referred to three times in the Court's opinion (304 U. S. 27, 53-4).

Obviously, the State's part of the enterprise includes provision of means for compliance with the principles of the federal statute, including the principle of the *Boyd* case.

It cannot be said that the State, or an agency of the State, can confront the Federal Courts with a plan which violates principles of bankruptcy, and insist upon its approval.

(g) The value of the assessable lands of this petitioner far exceed the amount of its debts.

As shown at length in our opening brief, the conservative value of the privately owned lands in the district (at least $50,000,000), is two and one-half times the total amount of the district's debts, even assuming that its whole bond issue is still owing (Our Brief, pp. 64-66). Appellee does not dispute this.

These figures ignore the property owned by the district itself, and ignore the fact (also shown in our opening brief), that the district's power revenues alone will amortize and extinguish nearly half of the district's total debts, even on its own theory. It follows that in actual fact, the conservative value of the privately owned lands in the district is from four to five times the amount of debts which they must be looked to to pay, even assuming, with appellee, that the whole bond issue is still owing (our brief, pp. 66-71).

The situation confronting this Court may, therefore, be summarized as follows:

This petitioner borrowed $16,190,000 and issued bonds therefor. Largely with the bondholders' money it acquired assets, the present value of which, as shown by its own records, exceeds $20,000,000 (our brief, p. 64). As security for the moneys borrowed, its contract with the bondholders encumbered the lands of the district, consisting of 189,000 acres, the present value of which (largely attributable to the bondholders' money) exceeds $50,000,000.

In these circumstances, then, with corporate assets of over $20,000,000, with lands chargeable for its debts worth at least $50,000,000, with power revenue sufficient to amortize and discharge nearly half of its total debt on its own theory, the petitioner now tells the Court that it should be permitted to repudiate half the principal amount of its

debt, and the whole (as to appellants) of six years of delinquent interest.

A more striking violation of the rule of common honesty laid down by the Supreme Court could hardly be imagined.

B. THE FACTS CONCERNING FAIRNESS OF THE PLAN.

The first point is this: that in legal effect *there is no finding that the plan is fair.*

(a) The issue of fairness is at large: This because the trial Court's finding is based on Irrelevant Facts.

The trial Court found, simply in the language of the statute:

> "That the plan of composition as offered by the petitioner herein is fair, equitable and for the best interests of its creditors * * *" (R. 214).

But the Court's opinion discloses that this finding is based in large part on the proposition that the major proportion of creditors consented to the plan. The opinion below reads in part:

> "We consider as most forceful, irrefutable evidence of the fairness of the plan the indisputable fact that more than 90 per cent. of the invested capital in the bonds of the District has taken advantage of it. The legal requirement of debt composition under Chapter IX of the Bankruptcy Act has been exceeded by nearly 25 per cent. of the affected invested capital."

As the Court said in *Case v. Los Angeles Lumber Products Co.*, ... U. S. ....., 60 S. C. 1:

> "Hence, in this case the fact that 92.81% in amount of the bonds, 99.75% of the Class A stock, and 90% of the Class B stock have approved the plan is as immaterial on the basic issue of its fairness as is the

> fact that petitioners own only $18,500 face amount of a large bond issue."

See the trial Court's entire discussion of this point, Record, pages 175-6.

It is settled that such a finding will not sustain a decree; on appeal, the Court either orders a new trial or itself examines the evidence, makes a finding one way or the other, and affirms or reverses accordingly. Thus, in the case of

In re Welsh, 5 F. (2d) 918,

it was held that although both the Referee in Bankruptcy and the District Court had concurred in a finding, it would not be accepted on appeal because it appeared that the Referee and the Court below took account of evidence which should not have been considered on the question.

See, also, for example, *Saari v. Wells Fargo Express Co.,* 109 Wash. 415, 186 Pac. 898, where the Court said:

> "In cases tried by the court, we ordinarily consider that improper and incompetent evidence is given no prejudicial weight or credence, but here the contrary affirmatively appears. The report of Benjamin to the police department was improperly admitted, and was given undue weight and improper analysis by the trial court."

Metropolitan State Bank v. McNutt, 73 Colo. 291, 215 Pac. 151:

> "The general rule that it is presumed that the court considered only competent evidence cannot be applied here, because it is shown by the bill of exceptions that the court rested its conclusions on evidence which is not competent on the issue in question."

In the present case, therefore, the trial Court's finding cannot stand; and the question whether the plan is or is not fair is at large. We have shown at length that it is not, and supplement that discussion below.

(b) The question of fairness is independent of the question how much the District owes.

Obviously the question whether the proposed plan is fair is wholly independent of the question how much the District owes. Much of appellee's argument resolves itself into the argument in substance that (a) Appellee needs relief; (b) Therefore the plan is fair.

(c) Petitioner has not shown that its plan is fair.

We now discuss the important items of evidence put forward in appellee's brief to support its contention that the plan is fair.

The Giannini Foundation, or Benedict, Report, and the testimony of Dr. Benedict at the former trial, do not show that the district is now unable to pay its debts.

Appellee's brief contains numerous statements to the effect that the Benedict, or Giannini Foundation, Report, shows that the petitioner district is so insolvent as to require the adoption of the petitioner's plan of composition (Br. Appellee pp. 6, 61). There is no justification for this statement. The report was originally the basis for the first refunding plan, wherein the district agreed in 1933 to refund the indebtedness of the district for the principal amount of $16,191,000 in 50 year sinking fund bonds, with interest at 4% and 4.4% (Ex. OO, pp. 90, 91). That such a plan was justified we may agree, but that the report gives any basis for the repudiation of the major portion of the district's indebtedness proposed in the current plan is not true.

The Giannini Foundation Report (Ex. 35) and the testimony of Dr. Benedict at the former trial (R. 432-471

incl.) relate only to the 3 year period 1929-31 (Ex. 35, p. 23) (R. 435) (*not,* except as to a supplemental study of 26 admittedly non-typical large corporate operations (Ex. 35, pp. 19, 64), for *six* years, as appellee states (Br. Appellee p. 5). This was a panic period admittedly not typical (R. 451), the end of which was *nearly 7 years prior to the trial of the case below.*

The report therefore is of little value on the question of present ability to pay.

In the meantime there have been many substantial changes. Testifying in April of 1936, at the former trial, Dr. Benedict stated "it is true, I think, that costs are being somewhat reduced from what they were in the period when this survey was made" (R. 471). The agricultural price index stood at *87* in 1931, 70 in 1933, and *121* in 1937 (Br. Appellee, App. A), showing a marked rise in agricultural prices at the same time that costs were dropping, so that the net result of operations, which Dr. Benedict considers the essential question (R. 456) was very much better at the time of the trial than it was in 1931.

The Giannini Foundation Report was prepared on the assumption that the $4,500,000 in mortgages (Ex. 35, p. 109) ought not to be scaled down in any reorganization (R. 458-459). It was also prepared upon the assumption that the debt should be such as could be carried by the large land owners (R. 470). These include large corporate enterprises for colonization of the land, as well as corporations operating foreclosed lands (Ex. 35, p. 64), such as California Lands, Inc., a Trans-America subsidiary (R. 473).

The report is not a study of the ability of the district as a *whole* to pay taxes, or of the average within the district, but only of certain of the poorer lands. Of the total assessment levied for the year 1930-31 ($1,194,-

585.35), there was first *eliminated* from consideration in the survey the city lands, having an assessment of $132,219.85, and rural properties of less than 20 acres, and land not sampled, of $605,619.99, or a total of *$740,924.39, or 61% of the assessed value.* There was *included* in the studies *only samples* from properties having an assessed value of *$456,745.51 (Ex. 35, p. 103), or 39% of the total assessed value.*

That the samples studied were from the poorer situations in the district is demonstrated by a comparison of the total tax delinquency for the entire district in 1931, of 17.63% (Ex. 35, p. 103), totaling $210,596.89 (R. 667) with the delinquencies of $199,731.32, or 43.73% for the lands sampled in the survey. This leaves $10,865.57 or *1.4%* as the *delinquency,* of the property *not included* in the survey, having an assessed value of $740,924.39, as against a *delinquency* of 43.73% for the lands *included* in the survey (Ex. 35, p. 103), having an assessed value of $456,745.51.

While the record does not disclose which of the properties sampled, including 1638 farms over 20 acres in size, were the ones substantially delinquent, it does appear that delinquencies were very much heavier for the large corporate properties (R. 470), and that individuals operating family size farms are much more efficient than large corporate and individual operators (Ex. 35, p. 64). These facts, coupled with the low (1.4%) delinquency on the farms under 20 acres, suggest that the major delinquency was in 39 large holdings comprising 64,000 acres (R. 681) in the district, including Trans-America holdings of 6000 acres (R. 473), and that the owner-operated farms were earning sufficient to pay their taxes, even in the depths of the depression.

The farms covered by the report are limited to 150 farms out of 2800 in the district, being the middle 50%

of 300 farms selected by lot out of 1600 farms in the district (R. 470) (Ex. 35, p. 23) (R. 467). In these 150 cases, investigators went to the farmers and in "one sitting" (Ex. 35, p. 23) elicited such information as they could, based on the *farmer's remembrance* of his transactions during the preceding 3 year period (Ex. 35, p. 24). It is admitted in the report that the records thus secured will be "subject to some little error", and that "the incentives for biased replies are greater in the present case than in ordinary farm management studies" (Ex. 35, p. 24).

The results achieved in the study of deciduous fruits, for example (R. 435, pp. 32 to 37), indicating a very large variation in results and a rather low profit or loss, are in marked contrast to results obtained by the University of California in one of the same years by carefully kept records of the operation of peach orchards in Stanislaus County, where, in the year 1929, the University of California study, based on accurate records, shows a *per acre net profit of $467.50* (Ex. 35, App. H, p. 95, and Table 9 of App. H, p. 102).

It is apparent on the face of some of the tables that cost allowances for family labor are, in many cases, fictitious, and create the *illusion* of a loss on operations, where, *in fact,* a *profit* was made. While space does not permit us to point out the numerous examples of such obvious fictitious family labor charges, we call attention, as an example, to Schedule No. 244 in Table 29 (Ex. 35, p. 51), showing a net loss of $42.40 per acre. Table 27 (Ex. 35, p. 49) shows that on this same ranch (Schedule 244) there was a total labor charge of $105 per acre, of which $7.50 was hired, and *$97.50* was *family labor*. There are a number of farms shown in Table 27 where all of the labor was hired, but the *most* paid on any farm where *all* of the labor was hired was *$39.51* (Schedule 320, Table

27, Ex. 35, p. 51). It is a fair inference that the family labor has been over-valued by $65, in Schedule 244. Reducing the cost charged on Schedule 244 by the $65 per acre overcharge, shows a *profit* of $23 per acre instead of the *loss* of $42.40 per acre. An examination reveals similar discrepancies throughout all of the tables; and we believe it is a fair statement to say that the elimination of *fictitious labor charges for family labor alone* results in showing a rather substantial profit on the average, for the farms studied in the Giannini Foundation Report.

The Court will also note that in Tables 8, 9, 10, 14, 15, 16, 21, 19, 22, 25, 27, 28, 32, 33, 34, 38, 39, 40 and 43 of the Giannini Foundation Report (Ex. 35), showing costs of operation of specific farms, the *higest cost* per acre ranges from *10 to 40 times* the *lowest cost* per acre for the *same type of crops,* on the *same type of lands,* on farms of *similar acreage.* This variation alone is so contrary to the probabilities as to suggest that the study cannot be relied upon.

The report contains studies of large corporate organizations during the period 1926-27-28, showing, as Dr. Benedict put it, "rather heavy losses" in those years, when they operated directly (R. 438). That these operations are not typical is demonstrated by the fact that when the same lands were rented to individual operators, they received a small net return, even in those years of panic conditions (R. 439). The report admits they were not typical (Ex. 35, p. 64, p. 19): The owners, being banks and colonization companies, were essentially speculators, not operators (Ex. 35, p. 64).

Nowhere in the Giannini Foundation Report, or in the testimony of Dr. Benedict, is the opinion expressed as to what amount the district could and can pay, even as of that time. As above stated, the report was originally the

basis for a refunding plan for payment of *the entire principal amount* of the indebtedness (Ex. OO, p. 90).

The testimony of Mr. Momberg does not show that the district is unable to pay its debts, but tends to prove the contrary.

Appellee states (Appellee Br. p. 6) that the testimony of Mr. Momberg shows the same situation that Dr. Benedict had found, and that the lands of the district are not now operating at a profit (Appellee Br. p. 61). Both of these statements are unsound. Mr. Momberg testified only concerning lands taken over on foreclosure by the Bank of America and affiliates. Dr. Benedict testified (R. 438), and the Giannini report showed (Ex. 35, p. 64) that this type of corporate enterprise was much less efficient than the owner operated farms comprising the bulk of the district, and were losing (R. 438) in the period 1929-31. The operation of California Lands, Incorporated, was therefore not a typical operation but a bad one. However, contrary to the statement in appellee's brief, the testimony of Mr. Momberg was to the effect that California Lands, Incorporated, was making a *profit*—not losing money in the period from 1935-38 (R. 488, 489). Mr. Momberg did not testify as to his opinion of the fairness of the plan or as to the results of operation of the average farm. He did testify that the lands which he managed were average for the district (R. 49), that 67 sales had been made (R. 489), that the average sales price for the property which the company now holds is $135 per acre (R. 485), that although properties were operated at a loss in 1932 (R. 481), the net result of operating all properties in the years 1935-38, inclusive, showed a profit (R. 488, 489), that average operating expenses were $27 per acre, that the $3 per hundred tax rate amounted to $1.75 per acre, and that this represented only 5% or 6% of the operating cost of the farms (R. 494).

There is no evidence in the record that the RFC refused to lend any more money, as claimed by appellee (Appellee's Br. p. 61).

Since the district did not place in evidence any of the appraisals or even the application for the loan made to the RFC, the inference is that the appraisal was favorable to a greater loan. Presumably the RFC followed the statute (43 U. S. C. 403) which says that before making a loan the RFC must be satisfied that the borrower will be able to get in "a major portion" of its bonds at "the average market price of such bonds over the six months period ending March 1, 1933", i. e., at panic prices.

The amount of the RFC loan is therefore no evidence concerning the ability of the district to pay.

Appellee's statement (p. 61), that "The R.F.C. concluded the District could not carry a greater loan than the plan provides for" is therefore (to put it mildly), unsupported by the record.

(d) The actual net income of petitioner during the last three years (deducting abnormal power revenue) would service a bond issue of nearly $14,000,000. It offers $8,500,000.

As noted above, the value of the lands in the district is conservatively two and one-half times the amount of its debts, which are a *first charge upon those lands.* We now discuss the income-producing capacity of the district, i. e., its ability to pay its debts *without recourse to the security.*

We stated in our opening brief that, despite the fact that the petitioner district has levied an extremely low tax of $1.75 (R. 490) or $1.80 (R. 517) per acre, entitling the landowners to 4 acre feet per annum per acre, the cash on hand in the district treasury increased from $346,313.61 on December 31, 1934 (R. 852) to $1,578,446.14 on

November 1, 1938, a *gain* of *$1,232,132.53* in three years and ten months. In answer thereto, in several places in appellee's brief (pp. 62, 71), appellee has stated that this was entirely due to a "providential" power yield. An analysis of the income and expenditures of the district proves that this is not true.

Since the data for 1938 is not complete, we shall consider the years 1935, 1936 and 1937. The actual power revenue and total revenue received by the district in those three years was:

Year	Power Revenue	Total Revenue	References
1935	$ 551,047.22	$1,037,025.07	(R. 863)
1936	584,429.64	1,194,075.78	(R. 873)
1937	602,008.94	1,137,342.72	(R. 881)
	$1,737,485.80	$3,368,443.57	

The undisputed evidence, from the studies made for appellee by Thebot, Starr & Anderton, Inc., Consulting Electrical Engineers (Ex. OO, p. 105), the reports made to the RFC by appellee district (Ex. OO, p. 105, and R. 783), report of appellee to the District Securities Commission for 1936 (R. 729), and the testimony of appellants' witnesses Heinz (R. 894) and Louis C. Hill (R. 534) is that the average annual income from power revenue for the district is $500,000 or more. The excess power revenue over the normal amount of $1,500,000 for the three-year period 1935 to 1937, inclusive, was, therefore, *only* $237,-485.80. Subtracting the amount of power revenue in excess of normal ($237,485.80) from the actual revenue received by the district during the three years ($3,368,443.57), gives us normal gross revenue for the district, after eliminating the above normal power revenue, of *$3,130,957.77.*

During this period, the actual expenses for maintenance, operation, general overhead and capital betterments was as follows:

Year	Capital Betterments	Maintenance, Operation and General Overhead	Total Normal Expense and Capital Betterments	Reference
1935	$ 52,392.34	$276,550.25	$ 328,942.59	(R. 864/5)
1936	80,187.85	318,102.70	398,290.55	(R. 873/5, inc.)
1937	115,395.43	360,784.73	476,180.16	(R. 881/3)
Total	$247,975.62	$955,437.68	$1,203,413.30	

Total annual average expense and betterments $401,134.43[1]

There would thus be available for bond service in a three-year period of average power revenue, the difference between the corrected normal gross revenue of $3,130,-957.77[2], based on actual tax collections, rentals, etc., and normal power revenue, and the actual expenses of $1,203,-413.30, or a total normal net revenue for the three-year period of $1,927,544.47.[3] This amounts to *$642,514.62* per annum net income or surplus available for bond service.

1. This compares with average annual expense for capital betterments and maintenance, operation and overhead (excluding Crocker-Huffman contracts) for the two year period 1931-32, of *$287,605* (calculated from data at R. 693).

2. Collections from delinquent taxes during the period in question, being $396,066.85 (R. 863, 873, 881), or an average of $132,022.28 per annum, were probably about $100,000 per annum in excess of normal. To maintain tax collections at the same rate as collections for 1935-37, therefore, the tax rate would be increased in future years by enough to raise this $100,000, which, on the basis of $320,000 collections from a rate of $1.75 *per acre* (R. 490, 667) would require an increased levy of about 55¢ additional *per acre*, making the future rate, to maintain these tax collections, about $2.30 per acre.

3. This balance of the revenue for the three-year period 1935-37 ($1,927,544.47) would all normally be available in future for debt service. It is accounted for as follows:

Increase cash on hand from December 31, 1934 ($346,313.61, R. 852) to December 31, 1937 ($1,136,498.01, R. 880)	$ 790,184.40
Crocker-Huffman contract payments (capital expenditures which terminate July 1, 1941 (Ex. OO, p. 134)	201,932.81
Principal of drainage bonds (capital expenditures, last maturity, payable 1939, Ex. OO, p. 137)	31,800.00
Non-recurring items, i. e., Refinancing expense exclusive of interest paid depositing bondholders, 1935-37	213,403.65
Loss on Bank Deposit	74,724.47
Interest paid R. F. C. and depositing bondholders	843,259.06
Interest paid on drainage bonds and on old Irrigation District bonds	9,724.78
(from data, R. 864-5, 873-5, 881-3)	$2,165,029.17
Less power revenue in excess of normal, as calculated above	237,485.80
	$1,927,543.37
To balance	1.10
AVAILABLE FOR BOND SERVICE	$1,927,544.47

This normal average annual net income ($642,514.62) *is sufficient to pay principal and interest on a 50-year bond issue (such as was proposed in the first plan), bearing interest at 4%, of over $13,800,000.*[4]

The district's proposed plan provides for a 4%, 33-year issue of $8,250,000 to retire district bonds ($350,000 additional to retire Crocker-Huffman contracts will not be used (R. 511)). The actual experience of the three-year period 1935-37, *adjusted to eliminate excess of power revenues over normal,* with maintenance, operations and capital expense considerably higher than previously (R. 693), demonstrates conclusively that the district *can without any difficulty pay $5,500,000 more than is proposed in its plan, without increasing its collections from taxes.*

Thus the actual experience of the appellee during the last three full years demonstrates the grossly unfair nature of its plan. It operated during those three years under an assessment rate so absurdly low as to produce a rate of delinquency after one year of only 1⅓%, which is plainly less than the normal rate of delinquency in the best of taxing districts in normal times. But notwithstanding that fact, the income of the district (ignoring abnor-

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4. TABLE OF ANNUAL AMOUNT NECESSARY TO RETIRE BOND ISSUE OVER 50-YEAR PERIOD, WHEN PRINCIPAL AND INTEREST ARE PAID SEMI-ANNUALLY:

Interest Rate	$20,000,000 Bond Issue	$15,000,000 Bond Issue	$10,000,000 Bond Issue
3%	$ 774,831.00	$581,123.00	$387,415.00
4%	928,108.00	696.081.00	464,054.00
5%	1,092,475.00	819,356.00	546,238.00

TABLE OF ANNUAL AMOUNT NECESSARY TO RETIRE BOND ISSUE OVER 30-YEAR PERIOD, WHEN PRINCIPAL AND INTEREST ARE PAID SEMI-ANNUALLY:

Interest Rate	$20,000,000 Bond Issue	$15,000,000 Bond Issue	$10,000,000 Bond Issue
3%	$1,013,736.00	$760,802.00	$506,868.00
4%	1,150,720.00	852,040.00	575,360.00
5%	1,294,136.00	970,602.00	647,068.00

mal power revenues), was sufficient to service a debt, set up precisely as in its plan, many millions of dollars greater than it offers to pay.

(e) Merced Irrigation District can, without difficulty, pay annual bond service on a $20,000,000 debt.

The average annual power income of the district is $500,000 (Ex. OO, p. 105; R. 783, 729, 894, 534). Average annual collections from land rentals, water tolls, normal collections of delinquent taxes (excluding annual extraordinary collections of about $100,000), interest, and miscellaneous revenue, as shown during the period 1935-37 (R. 863, 873, 881), exclusive of current taxes, are about $120,000. The total normal annual revenue other than current taxes is, thus, $620,000. Average annual expenses, for capital betterments, maintenance and operation, and overhead, based on actual expenditures during the period 1935-37, are $400,000 per annum (supra). The annual income available for debt service, before the levy of current taxes is, therefore, $220,000.

We can calculate the amount which can be produced by a levy on the land on the basis of experience. During the past three years, when, according to the testimony of Mr. Sargent, the average assessed value of an acre of land was $60, and the tax rate was $3 per hundred, the levy was *$1.80 per acre,* or according to Mr. Momberg, who testified that he managed average lands in the district, *$1.75 per acre* (R. 490). Exhibit 25 (R. 667) shows that collections for the year 1937-38, to the last Monday in June of 1938, were $320,516.17 (R. 667). It is a simple calculation to determine that if a rate of $1.75 per acre will produce $320,000, a levy of $1 per acre will produce $183,000, a levy of $2 per acre will produce $366,000, a levy of $3 per acre will produce $548,000, a levy of $4 per acre will produce $731,000, a levy of $5 per acre

will produce $915,000, and a levy of $6 per acre will produce $1,100,000. In order to ascertain the amount available for bond retirement, it is only necessary to add to these sums the $220,000 net revenue left from other income of the district after paying its current expenses and capital betterments. Adding the $220,000 thus available, it appears that a levy of:

$1.00	per	acre	will	produce	annually	for	bond	service	$403,000.00,
2.00	"	"	"	"	"	"	"	"	586,000.00,
3.00	"	"	"	"	"	"	"	"	768,000.00,
4.00	"	"	"	"	"	"	"	"	951,000.00,
5.00	"	"	"	"	"	"	"	"	1,135,000.00,
6.00	"	"	"	"	"	"	"	"	1,320,000.00.

A reference to the table in the footnote (supra) shows what amounts of bond issue at the interest rates shown can be retired by these payments. A *$6 per acre* rate will retire *$20,000,000* in bonds bearing *5%* interest over a thirty year period. A *$5 per acre* rate will retire a *$20,000,000, 5%* bond issue over a fifty year period, and a *$4 per acre* rate will retire a *4%, $20,000,000* bond issue over a fifty year period. Since the improvements paid for by the bond issue will far outlast a fifty year period from today, and the district once approved such an issue (Ex. OO, p. 90), we think an issue of that maturity proper.

This brings us to the question as to what a proper rate per acre would be.

Reference to the record in the case of Palo Verde Irrigation District now before the Court will disclose that in that district the average acre of land actually pays from $5.50 to $6 per acre in irrigation district charges (*Jordan, et al. v. Palo Verde Irrigation District,* Case No. 9133, U. S. C. C. A., 9th Cir., R. pp. 288, 321, 322, 312). The record in that case discloses that that district has a much higher percentage of unimproved alkali and worthless land than has the Merced Irrigation District. It also will show

that that district is limited in its productivity to alfalfa, cotton, cattle and grains (Palo Verde Rec. p. 314). The record in this case shows intensive cultivation in Merced District. Sixty-one per cent of the total assessed value in the Merced Irrigation District is contained in the cities within the district, and in 1100 farms of under 20 acres each (Ex. 35, p. 103). A large area in Merced District is planted to various types of fruit trees and vineyards. The rest of the land is suitable, for the most part, for the crops raised in the Palo Verde Irrigation District (Ex. 35). Costs are higher in the Palo Verde Irrigation District for farming and for transportation, because of its distance from market (Palo Verde R. p. 314). Merced Irrigation District is very fortunately situated geographically.

Water costs, even for field crops, ranging up to $20 an acre, in places in Southern California and in the lower San Joaquin Valley, are matters of common knowledge (Ex. OO, p. 145).

If Palo Verde Irrigation District can pay $6 per acre, certainly Merced Irrigation District, with its superior advantages, can also do so. But if Merced pays only $6 per acre, it can pay all of its normal costs of betterments, maintenance, operation and overhead, and *still service and retire a $20,000,000, 5% bond issue in thirty years.*

The increased development of the district is insurance against recurrence of past financial problems.

Appellee did, as it claims, unquestionably have serious financial problems during the years prior to 1934. Probably the greatest problem arose from the fact that the period, just as the district was getting started, and while it was still being colonized, turned out to be the driest period in the recorded history of the area. This had the

two-fold effect of reducing power revenue substantially for that limited period, and somewhat impairing water supply for irrigation purposes. The period was also the period of the most serious agricultural and business panic in the history of the United States.

But in the three-year period, 1935 to 1937, inclusive, there was a $237,000 excess of power revenue, and in 1938 an excess of over $200,000 of power revenue. At the same time, the index of agricultural prices rose from a low in 1932 of 65 to a high in 1937 of 121 (App. Br. Appendix), while even in April, 1936, Dr. Benedict noted a decrease in agricultural costs. The enormous increase in efficiency of farm machinery during the past five-year period, and the tremendous saving of cost as a result, are matters of common knowledge.

As of the date of the trial, the selling price of the representative lands (R. 492) held by California Lands, Inc., averaged $135 per acre (R. 485), sixty-seven sales had been made (R. 489), and nearly all sales were made on installments (R. 489), so that the payments which had to be earned from the land must average between $15 and $20 per annum, principal and interest, depending on the length of time the purchase contracts ran.

There is a tremendous demand for agricultural lands at a reasonable price. The report of the Governor's Commission on Reemployment of the State of California, made September 30, 1939, says (p. 28), "The most casual survey reveals that thousands of farmers with farm experience are unable to buy or rent land. At the same time, large scale farming is more prevalent in California than in any other state".

Thirty-nine owners in Merced Irrigation District hold over one-third of the land in the district (R. 681). A very

small percentage of the area of land in the district (1100 farms under 20 acres and the cities) sustains 61% of the assessed value of the district. With the tremendous demand which exists for small farms, and the large amount of land available for subdivision in the district, it is reasonable to expect a great increase in the intensification of agriculture within the district. With continued development and stability, many of the problems of the past will be, or have been, solved.

The solution to the problem of uneven power revenue is a fixed maturity bond issue with flexible sinking fund requirements.

The remaining problem of variation of power revenue was considered in the refunding plan of 1933, and was very satisfactorily solved in that plan (Ex. OO, p. 91). The arrangement in that plan was that all of the bonds should have a fixed 50-year maturity, that part of the bonds should bear 4% interest and part of the bonds 4.1% interest, and that the district should set up a sinking fund to purchase bonds in accordance with its revenue. Thus, in periods of subnormal power revenue it would retire an excess amount of bonds and less, or none, when power revenues were low.

This is the answer to the lean and fat cycles in the revenue of the district, rather than the unnecessary repudiation of bonds, proposed in the district's current plan.

FIFTH PROPOSITION: THE CLAIMS WERE IMPROPERLY CLASSIFIED AS BEING ALL OF THE SAME CLASS.

See our brief (pp. 74-76), and brief of Florence Moore (pp. 26-32). One point there emphasized is this:

By Section 83(b) of the Bankruptcy Act:

> "The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute *a separate class or classes of creditors.*"

By the contract between petitioner and RFC, the petitioner pledged the revenues to be received from power,

> "in each calendar year commencing January 1, 1936 except the first $100,000 thereof and except any amount in excess of $575,000 in each such calendar year * * *"

The petitioner agreed that,

> "such allocation shall be irrevocable" (R. 209, 210).

Thus, in the language of the statute, RFC is "the holder of a claim for the payment of which specific property or revenues are pledged".

This one point, we respectfully submit, concludes the case.

Appellee's only attempt to meet it is the following statement:

> "If refinancing is never consummated and the R.F.C. does not take the refunding bonds obviously the set up of the reserve funds and the allocation of the power is nullified."

This is nonsense. In the first place we have shown that the contract now existing between the RFC and appellee is an unconditional loan. Moreover, there is no shadow of a basis for contending that the RFC's exaction of this security is conditional upon getting in all the old bonds.

SIXTH PROPOSITION: THE DECREE UNLAWFULLY TAKES TRUST FUNDS AND VESTED RIGHTS BELONGING TO APPELLANTS.

Appellee begs the question. It says the very object of the bankruptcy laws "is the equitable distribution of the debtor's assets among his creditors" (Br. Appellee, p. 81).

As a general principle of bankruptcy law, it is of course true that the purpose is an equitable distribution of *unencumbered* assets *among general creditors.* But bankruptcy has never gone to the lengths of taking property belonging to a *creditor* and giving it to the *debtor.* Appellee fails entirely to meet the proposition that the bondholders *are not merely creditors.* They are the *equitable owners* of the assets of the district.

The proposition here is that the actual equitable ownership of the bondholders is taken from them—not merely that their contracts are impaired. Bankruptcy may impair a contract but it may not confiscate property, and that is what appellee seeks to do here (see Our Brief p. 77). We refer also to the discussion in brief of appellants in the case of *Moody et al. v. James Irr. Dist.,* No. 9353, now before this Court, particularly pages 74-89.

ON THE REMAINING POINTS WE REFER TO OUR OPENING BRIEF.

Lack of space prevents reply to appellee's treatment of the remaining points in our opening brief. We therefore refer on these matters to our opening brief, except as to our Ninth Proposition, which is that it is *res judicata* between the parties that the Constitution forbids the granting of the relief sought. The separate reply brief of Mary

Morris, filed herein by Mr. George Clark, replies fully to appellee's discussion of this point.

Dated, San Francisco, California,
December 26, 1939.

Respectfully submitted,

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No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

WEST COAST LIFE INSURANCE COMPANY (a corporation), PACIFIC NATIONAL BANK OF SAN FRANCISCO (a national banking association), et al.,

Appellants,

vs.

MERCED IRRIGATION DISTRICT,

Appellee.

SUPPLEMENTAL CITATIONS IN SUPPORT OF PLEA OF RES JUDICATA.

(Filed by appellants pursuant to permission at hearing of cause, and containing particular reference to the case of Chicot Drainage District v. Baxter State Bank.)

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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The following case, decided January 2, 1940, cites the case of *Stoll v. Gottlieb* discussed in the separate opening brief on the issue of *res judicata*. It determines a point directly contrary to the finding of the United States District Court in this cause. It establishes that, if in the prior proceeding under Section 80 we had obtained merely the judgment of the District Court against the power of Congress to change the bonds under the bankruptcy clause of the Consti-

tution and under a grant of powers such as are in Section 80, the decree would have been *res judicata,* although in a later case the Supreme Court held the section void. The prior decree of the District Court in the case referred to was rendered under old Section 80. It readjusted the bonded indebtedness of a drainage district located in Arkansas. The decree was not appealed from. After the decision in the *Ashton* case, a bank holding certain of the bonds which had been readjusted brought suit to enforce them and attacked collaterally the District Court judgment which had been pleaded as *res judicata,* claiming that on the face of the record it was void. This bank had appeared in the proceeding under Section 80 but it obviously had not accepted the benefit of the judgment. The Circuit Court of Appeals upheld the contention of the bank that the judgment under Section 80 was void. But the Supreme Court of the United States ruled that such judgment concluded the parties appearing as to the question of the constitutionality of the grant of bankruptcy power that had been made by Section 80 to the United States District Court, and that the decree of said Court was binding on the bank.

> *Chicot Drainage District v. Baxter State Bank,* Advance Sheets 84 L. ed. 277 (decided Jan. 2, 1940).

The converse of this would be true and the following finding of the District Court here is clearly erroneous.

> "The Court finds that said proceeding so dismissed was based upon a law wholly null and void and which conferred no jurisdiction upon

> the court and that there was no judgment on the merits in said proceeding. This court finds that the proceeding now before this court is based upon an entirely different law and one which does confer jurisdiction upon the court, and that petitioner herein is not barred in this proceeding by res adjudicata or otherwise."
>
> (R. 217.)

Neither the prior judgment of the Circuit Court of Appeals nor the directed decree of dismissal entered by the District Court was void and the finding should have been that the contracts involved *were construed* by a prior judgment wherein it was held (a) that Congress was powerless to grant authority to the District Court to make changes in the contracts because of their public character and (b) that, because of the contract clause of the constitution, the objection was not waivable through state consent. It should have been held that the judgment went on the ground the agency was invalid and not for defect in plan.

And the Court should note that the case of United States v. Bekins does not hold that state consent is not necessary to the operation of Section 83, which we say is invalid because it employs the same condemned federal agency, the United States District Court, for the purpose of putting into effect the plan.

The judgments pleaded in support of *res judicata* were made in the face of the following finding which was made by the District Court on the entry of the decree which was appealed from and reversed.

> "That said plan of Readjustment does not, nor does any order or decree of this court in this proceeding, or otherwise, interfere with (a) any of

> the political or governmental powers of petitioner, or (b) any of the property or revenues of petitioner necessary for essential governmental purposes, or (c) any income producing property, except to the extent that said Plan of Readjustment so provides. That no changes or modifications have been made in said Plan of Readjustment and that no changes or modifications are necessary or desirable."
>
> (See the prior findings at page 246 of the Transcript of the prior proceeding. This Transcript is Exhibit "OO". Copies of the Exhibit were filed in lieu of printing.)

The same finding is made here through the finding and the decree that the plan complies with new Section 83. Each section contains a provision setting out the limitations on power which required the making of the quoted finding in the first cause.

Clearly the said case of *Chicot Drainage District v. Baxter State Bank* shows the doctrine of *res judicata* applies to questions of law resulting in construction of contracts and affixes finality and permanency to rights resulting from such construction.

The following case was a suit by a bank to enjoin the collection of taxes which various political subdivisions in the State of Kentucky were attempting to levy under a law passed in 1932. In its complaint, the bank pleaded generally the invalidity of the taxes and further that as to certain defendants the bank's exemption from the taxes attempted to be levied had been previously adjudicated. The State Court judgment went generally for the defendants. The bank claimed impairment of its contract rights and appealed to the

United States Supreme Court. The record showed that in prior litigation involving taxes of earlier years a final judgment had been rendered for the bank and against part of the defendants, sustaining the contention of the bank that its charter and its acceptance of a certain Kentucky statute constituted a contract and that the proper construction of this contract meant that the bank's property was immune from taxes. The defendants affected by the prior judgment obviously claimed that the prior judgment could have no effect upon taxes levied in later years or under the later statute enacted in 1932. That is the argument generally made against a judgment to the effect a corporate charter makes corporate property exempt from taxation. But when the judgment goes on a ground that is general, it is settled that it controls and determines the invalidity of taxes levied in later years or under different statutes. On the appeal by the bank in the case referred to, the Supreme Court of the United States held that the ruling as to the existence of the contract and as to the construction to be placed upon it was, as between the parties to the prior litigation, binding and determined that the later taxes were invalid. It held that, on the basis of a prior decision, the Supreme Court of Kentucky had properly ruled in other litigation that there was in fact no contract of exemption at all. It accordingly reversed the judgment appealed from as to those taxing agencies which were parties to the prior cause and affirmed the judgment as to the remaining defendants. While the case does not as does the case of *New Orleans v. Citizens State Bank,* quoted from at page 7 of the opening brief on the issue of *res judicata,* give the

reason underlying the ruling, it is obviously based on the proposition that when the construction of a contract is litigated and a *right* under it that is general is adjudicated, the judgment resting on such construction is conclusive when the contract is before the Court in a second suit between the same parties and the *same right* is claimed or relied on. The prior determination made the bank's property exempt from taxes levied by the defendants which were parties to the prior cause.

Stone v. Bank of Commerce, 174 U. S. 409, 43 L. ed. 1027.

Dated, January 29, 1940.

CHAS. L. CHILDERS,
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Before: Hon. William Denman, Circuit Judge;
Hon. Clifton Mathews, Circuit Judge;
Hon. Albert Lee Stephens, Circuit Judge.

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a National Banking Association), et al.,
Appellants,

vs.

Merced Irrigation District,
Appellee.

ORAL ARGUMENT BY STEPHEN W. DOWNEY ON BEHALF OF MERCED IRRIGATION DISTRICT.

Monday, January 29, 1940.

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Pernau-Walsh Printing Co., San Francisco

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Appellants,

vs.

Merced Irrigation District,
Appellee.

ORAL ARGUMENT BY STEPHEN W. DOWNEY ON BEHALF OF MERCED IRRIGATION DISTRICT.

Monday, January 29, 1940.

Judge Denman. We will hear from the appellee.

ARGUMENT OF STEPHEN W. DOWNEY, ON BEHALF OF APPELLEE, MERCED IRRIGATION DISTRICT.

Mr. Downey. Your Honors, I have acted as counsel for the Merced Irrigation District for some twelve years,

and I hazard the statement that there has not been some period of every twenty-four hours during that time, or certainly during the last eight years, that I have not had occasion to consider the problems and the perils of the bondholders and the land owners. As Mr. Cook and Mr. Childers very properly say, these are common problems. I would give a good deal to be able to paint that picture as it actually is. Every time I try to do it, I realize the utter inadequacy of words to do it, so inadequate is the spoken or written word against the reality.

We start with a district which was conceived during the boom agricultural costs of the first World War in 1919. In 1920 the agricultural index ran over 200. At the time of trial November 1938, it was about 94 and it was down as low as 65 in 1932,[1] which gives you a picture of the relation of the times. 1920 was a period when the optimism of the bondholders and land owners ran skyward; when $5,500,000 could be spent merely to move a railroad, a very trifling part of the project.

Then we pass through the intervening years, when the agricultural index was still high: 1925, 1926, 1927, 1928—still high; 1929, still high, 1930, lower, 1931, still lower, and reaching an all-time low in 1932. Then rising somewhat again, with a big dip in 1938, but never reaching the prices of 1926, 1927 or 1928 and '29. And those latter prices were not even comparable with the prices at the time the District was formed or conceived in 1919 and 1920.[2]

1. See Appendix A, brief of appellee, Merced Irrigation District, extract from U. S. Department of Agriculture Report.
2. Id.

ASSESSMENTS NOT YIELDED BY LANDS.

Now, as the years went by in that District, commencing with 1926, 1927 and 1928, when, as I say, prices were still comparatively high, there gradually came the realization that even then the assessments were not being paid out of the land; that the money was coming in, not from the land, but from outside sources, based upon the hope and prayer that the District would be colonized and subdivided, and that the war prices would——

Judge Denman (interrupting). What do you mean by "coming from outside sources"?

Mr. Downey. It came from savings, your Honor; it came from money borrowed; it came from the surpluses of corporations which owned property there, and from the savings accounts of individuals who farmed the land.

Judge Denman. Is this in the record?

Mr. Downey. This is in the record, your Honor, yes (R. 440, 441, 442, 456, 462, 463, Ex. 35, pp. 114-124).

Then came the default in 1931, and from then on the attempt to hold up the value of those bonds, to maintain the credit and the stability of the District and of the county, with prices falling, and the final realization that collapse was inevitable; delinquencies mounting from 17 per cent to 37 per cent, to 62 per cent and the absolute certainty that if the District continued to function by servicing its bonds from there on, after the delinquency had reached 62 per cent, that it was merely a matter of a year or two until the delinquency was 100 per cent. When the outside sources of payment were exhausted, default was inevitable.

Judge Denman. What does the record show with regard to earning power during that time?

Mr. Downey. May I come to that in a moment? I will point out that the District never did have an earning power to service a bond issue of sixteen million, and if it is able to service the refunding bond issue which is to go to the R. F. C. when refinancing is complete, it will be able to do it only by the narrowest margin of safety.

BACKGROUND OF PLAN.

At that point, when the realization came that 100% delinquency was inevitable, unless defaults and delinquencies were immediately arrested, the bondholders stepped into the picture, and from there on, may it please your Honors, we find an able and aggressive bondholders committee and we find the Irrigation District cooperating to the uttermost with the bondholders to work out this problem, which was indeed a common problem. The statement made here in the argument about tax strikes and repudiation is unsupported by a single syllable of testimony. The evidence is all the other way.

Now, what followed, may it please the court? Investigations by the bondholders, and reports and studies and audits by the bondholders; the most intensive efforts on the part of the Bondholders' Committee and various large bondholders, big banks that had statistical agencies and statistical assistance at their finger points, to suggest a solution. At last, your Honors, they reached this point: that in order to determine how the problem could be met, a study should be made of the tax-paying ability of the District, and so they go to the University of California, the most outstanding, the most disinterested, the most able

to make a study of that kind. That study is made not by the District alone, not by the bondholders alone, but at the joint request of both (R. 434), in order to determine what could be done in this common situation. And finally, your Honors, we have *this* plan—the one before the court —the final effort of the bondholders to save what they could before all value was lost, the only plan which ever seriously interested the bondholders, the only one suggested which carries the stamp of feasibility.

Judge Denman. Does the record show that the University has advocated this—or presented facts on it?

Mr. Downey. The Giannini Foundation, or the Benedict Report, which the University of California prepared—it is all the same thing—the study was made officially by the Giannini Foundation of the College of Agriculture of the University of California, and Dr. Benedict, who is professor of agricultural economics on the University staff, was personally in charge.

Yes, it is a University of California report, your Honor. It advocated no particular plan. It merely found the facts on taxpaying ability of the District so bondholders and land owners could act intelligently (Ex. 35).

Now, this report, to my knowledge, is the only scientific, comprehensive report that has been made of tax-paying ability on a large scale and I will point out the detail and the importance of that report in a moment. Now, it is easy enough to go into an irrigation district and ask Mr. John Doe or Mr. Richard Roe, to testify as to what the lands can pay; that is not a difficult thing. It is easy enough to say, "Well, the farmers in peaches went broke", or "The farmers in grapes went broke". That can give us a

portion of the picture, but by no means the whole picture. To determine what a district or a governmental agency as an entity can pay is obviously a very difficult and very different operation, and in this case, the report or the survey, was made by the University with the idea of determining the facts, disinterestedly, fairly, in the interest of both bondholders and land owners and also in interest of the public because by this time the public interest generally was also vitally affected.

Now, what does this report show? In the first place, it is based upon a classification and appraisal of the lands in the District. That classification and appraisal was made by Mr. Cone, representing the District, and by Mr. Underhill, representing the Bondholders' Committee —again, the common effort to attain a fair determination of an essential fact (R. 742, 446, Ex. 35, pp. 126-133). Mr. Cone classifies the lands as approximately 40,000 Grade 1 lands, approximately 50,000 Grade 2 lands, and approximately 80,000 Grade 3 lands, or marginal areas (Ex. 35, p. 130). He points out that the land has no value at all, no market value at all, unless the bond issue is placed upon an "ability to pay" basis (Ex. 35, p. 127). Now, obviously, that is true. To talk about land having market value where it is encumbered by a bond issue that the land owners cannot pay is an absurdity. I submit, your honors, it is a contradiction of terms. Appellants speak in their brief of these lands having a value of $50,000,000, quite independent of the fact that it may be encumbered by a bond issue that the lands cannot pay at all.

Judge Denman. I think they are referring there to the fact that the tax sale might go on, all the property acquired

by the District, and then it is valued as against the value of the obligations, taking into consideration the Supreme Court decisions; I think that is what they mean.

Mr. Downey. I didn't intend to come to that point; I will come to that in a minute.

VALUE OF LANDS DEPENDENT UPON ABILITY TO PAY.

Judge Denman (continuing). Here, when we are talking of value, we are now assuming that the District performs all the things it promises to perform. Amongst other things, it promises—implied in the bonds—to go and acquire the land under the tax sale and sell it under tax sale; when they have so acquired it and also sold it, and it exceeds the amount of the composition offered—or if it would not do that, then a bankrupt is keeping part of his property and not paying all of his debts; that is the theory I caught that argument on.

Mr. Downey. I am a little ahead of my argument on that, your honor, but it must be clear that if the District cannot pay sixteen million dollars, that the lands cannot have a value anywhere near sixteen million dollars, because, by a process of pyramiding and collection of delinquency, the load keeps piling on one piece of land, and then on another, and then on another, until they can't pay at all.[3] If the District acquires all of the land and then sells one piece, that one piece immediately becomes subject to the entire bond issue—the vicious circle repeats itslf.

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3. See Appendix B Merced Irrigation District's Brief, describing process of pyramiding.

Every piece of land in an irrigation district is surety for the whole issue and for every other piece of property. Therefore, unless the bond issue is upon an "ability to pay" basis, nobody in the end can pay, nobody will buy land in the district and it has no market value. Of course, the very question we are seeking to answer here is whether the refunding bond issue represents the "ability to pay" basis. If it does, the lands have value, but not otherwise. So what we have to determine here is "ability to pay". Value is collateral to that. It is obviously a contradiction of terms to assume that lands can have value in excess of a bond issue which is a charge against them if they cannot pay it. "Ability to pay" is precisely what we are attempting to determine in this case. Once "ability to pay" is established, "value" follows automatically. But if you don't have "ability to pay" you can't have "value". However, I will pass that for a minute; I want to get into the Benedict Report.

BENEDICT REPORT.

Now, Mr. Benedict took all the farms in the District in excess of twenty acres, some 1600-1700 farms (R. 435), on the theory that that was the land which, in the main, would have to support the bond issue (R. 470). He then drew by lot a 20 per cent sample from those farms, so there would not be any question as to the fairness of the sample—all this being done under the supervision and with the cooperation of Mr. Fullerton, representing the Bondholders' Committee—and he gets a certain sample, some 300 farms, which is an enormous sample—the first study of this kind—then he makes an intensive study—

about nine months—to determine the costs of production and the revenue or income of the properties in 1929, 1930 and 1931—1929 was an excellent year. He found that all of those properties operated at a loss after payment of labor, out of pocket expenses and county taxes, with the exception of a few of the Grade 1 lands—about 40,000 acres of them in the District—during 1929 alone, and that after deduction of depreciation, all of the lands operated at a loss (R. 437, 471).

Then the question was raised as to whether that was a fair study, because it was claimed economic conditions in the District were better in 1926 and 1927 and 1928, as of course they were (Ex. 35, p. 114). Mr. Benedict then goes back, and the records not being available in detail as they were for the last three years, and the time being short, because they had consumed nearly nine months in this first study, takes 26 representative properties in the District which pay an assessment in excess of $2500—about 40,000 acres of those properties—and he makes a study of them, and he finds that the total net income on those 26 properties, before payment of taxes and assessments, in 1926, 1927 and 1928 was minus $246,000 (R. 441). In other words, before paying operating expenses $246,000 of outside money from outside sources was required to be put into those properties. It was not yielded by the lands. And after payment of the taxes and assessments, and the operating expenses, there was a net income of minus $1,300,000. $1,300,000 therefore was required to be paid on those particular properties (R. 441, Ex. 35, p. 116 et seq.) from sources outside the land.

Judge Denman. Not as capital investment.

Mr. Downey. It came from outside sources.

Judge Denman. None of the million dollars was capital investment?

Mr. Downey. No. In other words, during the years 1926, 1927, and 1928, when prices were high, when economic conditions were good, when the District apparently was prosperous, even then, the money that was required to meet these assessments was not being yielded by the land.

Now, not only that, but Dr. Benedict was called as a witness at the trial before Judge Cosgrove at Fresno in 1936, the first trial, under the first Bankruptcy Act. He was cross-examined in that case, your honors, as I remember it, for nearly a day. His testimony was stipulated into the record in this case before Judge McCormick, and he not only bore out his earlier statements, but he showed that even if prices returned to the 1919 level—which he said was utterly impossible, so far as anybody can predict —get this—that even then it was doubtful if the District would be able to carry on; and in connection with the discussion as to prices and other items, he indicated that the margin of safety possessed by the R. F. C. on its refunding bonds was exceedingly small (see R. 462-463; 471).

BONDHOLDERS' LETTER.

Now, after Doctor Benedict's report had been submitted, the parties again got together in an attempt to work out this problem. Now, mind you, there is no money at that time, no chance to make a cash arrangement for refinancing with the bondholders; at least, nobody is willing at that time, or since, to come forward with any money,

except this relief agency in Washington, and at that time there is no loan available from the Reconstruction Finance Corporation, and the parties sit down to work out this problem with the Benedict Report before them, which they both accept, although, admittedly, many inferences could be drawn from that report.

I hold in my hand Exhibit 37 (R. 736-754), which is the letter by the Bondholders' Committee, dated December 15, 1933, to the bondholders, explaining to them the condition of the District; this letter, among others, your honors, is signed by Milo Bekins, Reed Bekins, Victor Etienne, Hon. James N. Gillett (R. 754), and Myford Irvine, all members of the Bondholders' Protective Committee and all in representative capacity, or otherwise, appellants here. They represent a very large block of the dissenting bonds here.

Now, the bondholders are told by their committee that it is pleased to announce that a refunding plan has been adopted by the Board of Directors of the Merced Irrigation District, and that the voters have approved it at an election held November 22, 1933. This is the first refunding plan, the paper exchange. I might say to your honors the people of Merced approved that refunding plan by a vote of nearly 100 per cent, in an attempt to work out this problem, that then being the only plan which seemed feasible. Remember there was no money in cash then available for refunding purposes.

Judge Mathews. What was the date of that?

Mr. Downey. That is December 15, 1933.

The bondholders are told that the Committee now has 35 per cent of the bonds, and that in order that this plan

be consummated, the bondholders must deposit additional bonds thereunder, the District already having approved it (R. 737).

Judge Denman. What is the date of this study, the Giannini Foundation?

Mr. Downey. The study was completed just preceding this letter (Feb., 1933 and June, 1933—see Ex. 35).

The Committee points out the District's existing critical financial condition (R. 738). It speaks of the delinquencies mounting from 17 per cent to 37 per cent (R. 738); the decreasing farm prices, refers to the delinquency of 62 per cent (R. 739) which had been the last preceding delinquency; says that if it is necessary to levy taxes next year, the rate will be $15.60 per hundred dollars of assessed valuation (R. 740), says the 62 per cent delinquency came about as a result of a tax levy of $8.90; states that the foregoing figures

> "have been taken from the District's records, which the Committee has relied upon and checked to the best of its ability. It cannot, of course, guarantee them but it believes them to be correct" (R. 740).

The letter speaks of the shortage of funds for the operation and maintenance of the District; that such expenditures have necessarily been curtailed; that the irrigation system needs extensive repairs, betterments and extensions (R. 740).

> "As a result of its own investigation the Committee is of the opinion that conditions in the District are in fact as represented by the District's officials" (R. 741).

I cannot tell your Honors how many investigations and studies were made by the bondholders.

Then, the letter points out the causes for the District's inability to meet its bonded debt: first, that large areas of land were included, through inaccurate information

> "as to the capability of certain lands, and partly through desire to include as much land as possible in the District in order to spread the financial burden" (R. 741)—

as a matter of fact it just worked the other way. It points out that Mr. Cone

> "at the request of the District, completed a thorough classification and appraisal of the lands within the Merced Irrigation District"

and his

> "conclusions, in general, are verified by the Committee's representative, Mr. R. L. Underhill" (R. 742).

The letter then says that, of the 171,000 acres in the District, 90,000 acres are good land and 80,000 acres, taken as a whole, are capable of bearing but little of their share of the District's bonded indebtedness.

> "The future development of this land is problematical and the Committee is of the opinion that the possibility of substantial immediate income from these lands must be discounted" (R. 742).

Then, taking the good land, as found by the Bondholders' Committee—some 90,000 acres—they say that 17,000 acres of that land are above the level of the gravity distribution

of water—water has to be boosted up to those lands at a loss—leaving some 74,000 acres out of 171,000 acres, and the cities, upon which the burden of the District's obligation, in large measure, must rest (R. 743).

Then comes a comparison with the tax rates of Districts which are true competitors of the Merced District—we don't compete with Districts in Southern California, nor are we comparable with Districts in Southern California, or other districts mentioned here, but Modesto and Turlock are our immediate competitors—same type of land, same type of products, and exactly the same climate. The letter points to an assessment rate of $3.10 for Modesto and $3.00 for Turlock, and it compares that with the last—what we call the legal rate for the Merced District, $8.90—which produced a delinquency of 62 per cent (R. 744).

The letter then refers to the failure to colonize the District, which had been hoped for at the time of its formation; irregularity of the power income, which, of course, requires the building up of substantial reserves to guard against the collapse of farm prices and dry years and points out that the District then had—and this figure is rather important—about $1,167,000 of delinquent assessments (R. 747).

Now, this very letter refers to the University of California or Benedict report:

> "In the early part of 1933, the Agricultural Experiment Station of the College of Agriculture of the University of California completed a survey of farm incomes and expenses in the Merced Irrigation District from 1926 to 1931."——

Appellants say this report is only from 1928 to 1931——

> (Continuing) "While the compilation of such a survey is attended with extreme difficulty and the results must be carefully interpreted, the general conclusions brought forth were that farm income available for the payment of District assessments during 1930, 1931, 1932 declined at a rate even greater than the fall of farm prices, and that during those years the Irrigation District assessments required under the present debt could be met out of the earnings of only a small portion of the District's best and most highly developed land" (R. 747).

Then follows a statement of the first refunding plan of 1933: The District shall pay the bonds and coupons due January 1, 1933, and shall make no further payments for that year, no interest for July 1, 1933 (R. 748). That is important, because there is some point made by appellants as to our failure to take certain action with reference to coupons dated July 1, 1933.

Then follows the detail of the plan, which contemplates the exchange of one bond for another maturing in 1983, 50 years in the future. It is a sinking fund bond with some slight reduction in interest, and a period of seven years during which there is a substantial reduction in interest (R. 749).

Then,

> "During the period of more than two and one-half years in which the Committee has been negotiating with the representatives of the Merced Irrigation District, the members have given a great deal of their time to properly inform themselves as to the conditions which must be met by any workable re-

> funding plan. It has had the benefit of comprehensive investigation of underlying facts, not only by its own observers, but by the College of Agriculture of the University of California. In the opinion of the Committee, the refunding plan adopted by the District is designed to insure the maximum to the bondholders and, at the same time, not to impose burdens upon the District which will be beyond the ability of the land owners to meet." (R. 750.)

Then,

> "The Committee has assured the District that it will cooperate in any application made by the District to secure Federal or State aid in the purchase or refinancing of the District's bonds, and that in the event that funds for such purpose are made available from a Federal or State agency, such offer will be submitted to the bondholders." (R. 752.)

In other words, the District, having adopted this first refunding plan, now submits it to the bondholders with the stipulation on the part of the District that it will apply for Federal funds, and if it gets a loan, it will submit it to the bondholders.

FIRST REFUNDING PLAN REJECTED BY BONDHOLDERS. CASH PLAN APPROVED.

In the meantime, the Bondholders' Committee tries to secure deposit of the bonds under the first refunding plan, and, your Honors, appellants can talk about this first refunding plan not having contemplated a reduction in principal; why, it was mere paper exchange. For us to really realize that situation—they were putting off the inevi-

table day, a bond due in 1983, and, of course, the hope, I believe, that it would be possible to go out and buy in those bonds at heavy discounts, say fifty cents on the dollar, in the meantime.

Well, what happened? The Bondholders' Committee starts to solicit deposit of bonds under the first refunding plan, and a year later they have secured only 60 per cent (R. 497, 499). They had 35 per cent at the time the letter was written (R. 737) and after a year of intense solicitation they got up to 60 per cent and there it stopped. The bondholders were not interested. They refused to sanction the plan.

Now, in the meantime, the Merced Irrigation District representatives had gone back to Washington and had made application for a loan. Counsel says we represented that the power income would average $500,000 a year (Ex. OO, p. 105). We did. We went back to Washington and we made the very best showing possible to make, in the hope that the loan would be the biggest the District was able to pay; we made the best showing we could. We went there as any debtor goes to a bank and begs for money. No one else, no underwriter, no bank, nobody was willing to help, and all that could be suggested, in default of relief money, was exchanging one bond for another.

We came back from Washington and we submitted the R. F. C. offer to the Bondholders' Committee. What did the Bondholders' Committee do? Was there any high pressure or coercion? Absolutely not.

The Committee said, "We will submit the cash plan to the bondholders and see what they want." So they wrote the bondholders and asked them which they wanted,

the first refunding plan, or the cash plan (R. 496). The bondholders had the facts before them. The result of many studies. They had the letter from the Committee dated December 15, 1933 (Ex. 37) which I have quoted from. They had the Benedict Report, and many other things.

And, your Honors, the replies came back like an avalanche, 63 per cent of the bonds outstanding, an enormous vote, because many of the bondholders couldn't even be reached, voted to take the cash plan. Only about seven per cent voted for the first refunding plan. The District had nothing to do with it. In number, five to one voted to take the cash plan (R. 499, 503). This was a bondholders' plan, not a landowners' plan. We were not high-pressuring anybody. The bondholders said, "we want the cash," as I believe any man who was conversant with the affairs of that District would also have concluded. And there is no evidence that more than 7 per cent wanted the first refunding plan at any time.

So then the bondholders' committee, because of this referendum, adopted the cash plan, and then deposit was called for on the basis of the cash plan, and in October, about eight months later—the plan was adopted in February, 1935 (Ex. 13, R. 586)—there were on deposit nearly 90 per cent of the bonds for the cash plan (R. 344). That is what the bondholders thought about the cash plan.

Now, on October 4th, 1935, the R. F. C. directed the Federal Reserve Bank in San Francisco to buy these bonds that had been deposited; the money was paid to the depositaries and bills of sale were given to the R. F. C. and it is today the holder of the legal title to those

bonds, in almost every instance by bill of sale (R. 345), although in the last few months the custom has been for a bondholder to walk into the Federal Reserve Bank and the bond would be purchased for the account of the R. F. C. over the counter (R. 348).

In April of 1935, we filed in the Bankruptcy court under the first law. That case was tried in February, 1936, before Judge Cosgrave, resulting in a judgment approving the plan (Ex. OO, pp. 222-227).

Judge Mathews. What was the date of the original Chapter 9, Mr. Downey, Sections 78 to 80?

Mr. Downey. Your Honor, I can't give you that exactly.

Mr. Childers. May 24th, 1934.

Mr. Downey. Thank you.

That judgment—reversal of that judgment became final based upon a denial of certiorari by the United States Supreme Court in October of 1937 (R. 519). In the meantime, the State had enacted an Irrigation District Refunding Act (Chap. 24, Stats. 1937) which provided in effect for the condemnation of the dissenting bonds. The District filed under the State Act. There was an announcement of a decision on the preliminary features of that Act in March of 1938 (R. 381-383), then the decision of the United States Supreme Court followed, holding the second Bankruptcy Act constitutional. The District filed under that in June of 1938 (R. 8, 36) and the action which is before your Honors was tried in November 1938.

In the meantime, from the adoption of the cash plan in 1935, right on through the present moment, the District has operated practically under the plan, by virtue of

the stays which have been involved in these different suits and by virtue of certain emergency tax legislation which passed by the State of California, commonly known as Section 11 of District Securities Act (Stats. 1933, Chap. 60, as extended). We have had an emergency tax rate all of that time; the rate for the last few years has been $3 a hundred (R. 403). Now, the fact that we have reduced our rate to that figure, plus the fact that the landowners have taken advantage of certain emergency legislation permitting redemptions over a ten-year period, plus the fact that we have had two enormous power years —which I will come to in a little—plus the money which the Federal Government has poured into farming communities in the form of Federal Land Bank loans, has resulted in the District, during the last few years, not being prosperous, but being able to get along. Redemptions from the old delinquencies have come in at a substantial figure—several hundred thousands of dollars. The $3 tax rate, because it is low, has brought in more money. If we raise the rate, we really have no assurance we will get more money, and the encouragement resulting from the belief down there in the District that they are refinanced, has resulted in a present condition which is somewhat—well, it is certainly much better than what we have had before; we are getting along. The picture could change over night, either by reason of drought or shortage of water, or reduction in farm prices, or floods or a dozen other contingencies. There are many things which could change the picture over night and wipe out everything that we have been able to accomplish in the last few years.

Judge Denman. Was your drop in income due to drop in run-off, or was it due to a drop in demand?

Mr. Downey. No, there was no drop in demand; we have a firm contract for 20 years with the San Joaquin Light & Power Company; it is lack of run-off and other factors which enter into it, which I would also like to discuss in a moment.

APPELLANTS' REPLY BRIEF ON FAIRNESS OF PLAN.

Now, your Honors, the reply brief of the appellants, is in many respects, on the fairness of the plan, a substantially new argument and new matter—something not advanced before—as is also the argument of appellants here the other day on fairness. That is why it is so essential I should answer the new points in argument. That is primarily why I am talking about fairness of the plan.

It was asserted in the opening argument of counsel for the appellants here that the District Court ignored the facts, relied on the consents as establishing the fairness of this plan. Your Honors, that simply is not so. Judge McCormick's opinion goes into all of the essential elements involved in fairness—ability to pay, the Benedict Report, Mr. Momberg's testimony,[4] the appreciation in the value of the bonds. He also relies on the fact that the District is operating now on an emergency basis and that

4. It is said in Appellants' reply brief, and in their oral argument, that Mr. Momberg's testimony showed a substantial profit. To the contrary, his testimony (R. 474-494) summarized, shows farm income on fifty properties, 1932 to 1938 inclusive, after payment of taxes and farm expenses but before deduction of insurance, depreciation and head office overhead, to be $30,932.00 or an average of $4,414.00 per year. Deducting estimated share of expenses for district supervision which should be allocated to the same fifty properties (Merced office) or $5000.00, leaves the fifty properties in the red without further proper deductions for insurance, depreciation, etc.

the experience in meeting the assessments resulted, even at the rate of $8.90 per $100 in a 62 per cent delinquency, shows that the District obviously could not carry a bond issue of sixteen million, and attributes the better condition to the operations of the R. F. C. There was no contention at the time of trial, as is now made and as made in appellants' reply brief, your Honors. The contention as to the fairness of the plan is really made in the reply brief of appellants for the first time. It is an after-thought, the primary contention being before that we didn't owe sixteen million, that we only owe what we owe the R. F. C. plus what is owed on the outstanding bonds of appellants and therefore we could pay the dissenters 100 per cent of principal.

Mr. Douglas was reported by Mr. Cook to have made an address before the American Bar Association sometime ago to the effect that no consent should be solicited—if I got his statement correctly—until the plan was in court. Well, if he made such a statement as that he was referring to Section 77-B. As a distinguished lawyer before he was on the United States Supreme Court Bench, I call your attention to the address he delivered before the American Bar Association in 1937, after the *Ashton* case had been decided. I quote briefly (Legal Notes on Local Government, 1936-37, Vol. 2, p. 81 et seq.):

> "It is agreed that the most important process in debt readjustment"—he is speaking now of municipal debt readjustment—"is negotiation of its terms. * * * Few will dissent from the conclusion that this process of negotiation should be conducted openly and honestly by bona fide representatives of the debtor and of the creditors; nor can there be disagreement from

the conclusion that when a fair agreement is reached by a process of give and take between such bona fide representatives upon the basis of a full disclosure of all material facts, there should be some machinery for putting it into effect (p. 81). * * * Fairness of a plan is not always ascertainable by examining the terms thereof. Normally it will be necessary to inquire into the background of the plan and the activities of the negotiators to ascertain if the antecedent and collateral phases of the plan are free of overreaching and coercion.

"Conspicuous among such matters is the method by which assents to plans have been obtained. * * * Traditionally, one of the criteria of a fair plan has been the number of consents which have been obtained. But unless consents have been obtained openly and freely this essential hallmark of a fair plan can exist only in form, not in substance. The reorganization field is replete with instances of coercive practices whereby consents have been obtained, and of oppressive methods by which security holders have been whipped into line behind particular plans" (p. 86).

Then he goes on to say that

"While it may be wholly for bondholders to accept 50 cents on the dollar, it may be grossly unfair if that figure is reduced to a net of 45 cents by virtue of the Committee's deductions" (p. 86).

Now, on the fairness of our plan, consider this background: that everybody agreed that refinancing was necessary; that they had before them a disinterested, unbiased, able, scientific report by a state agency that, with that before them, the bondholders, themselves, said "We want the cash". And under those circumstances, what could be

fairer? What could be more reasonable, and wherein is there left any claim such as repudiation, or tax strike, or coercion, or similar charges that have been bandied here, your honors, charges not bandied at the time of this trial, or in the other trials?

APPELLANTS CLAIM THAT DISTRICT DID NOT ACT IN GOOD FAITH.

Now, at that point, I do want to refer to two charges that appellants did make in their opening brief. They did say that the District has not acted in good faith, that it has been guilty of constructive fraud. They have not argued that here, but they argued it in their opening brief and the reply brief. They say that arises by reason of the fact that the District diverted $717,000 from the Bond Fund to the General Fund. The last bond service levy was made in 1932-33; that is the levy that went 62 per cent delinquent. In subsequent years, as I pointed out, money came in on redemptions. In the meantime, the legislature had passed a law, Section 11 of the District Securities Commission Act (Stats. 1933, Chap. 60) providing that there need be no levy for bond service during this emergency period, and none was levied. The tax redemptions which were based on the tax levies prior to 1932-33, were properly put in the General Fund. Of the $717,000, all of it, with the exception of $320,000, represents delinquencies on levies prior to 1932-33, and all of the bond obligations, your Honors, up to July 1, 1933, have been paid in full (R. 400-404), so that leaves it not $717,000, but $320,000. That is the money that has come in since 1933 on the delinquencies under the levy of 1932-33. Now, whether the

trust follows through so that it may properly be said that the money should go into the bond fund, I don't purport to argue. I think it is debatable, but I don't regard it as important. What happened was this: When the first refunding plan was adopted, as you will observe from the letter that the bondholders' committee sent out and which I have quoted extensively, it was not contemplated that any interest would be paid on coupons due July 1, 1933 (R. 748). The coupons of January 1, 1933 have been paid (R. 400-404); that was to stand as payment of interest for that year, and accordingly, the District, in the utmost good faith continued, as these delinquencies came in, there having been no subsequent levy for bond service, to put the money in the General Fund. The Bondholders' Committee knew all about it. In their own letter to the bondholders it is stated that there will be no payment of interest due on July 1 of 1933; and, moreover, this plan before your Honors, and the plan before Judge Cosgrave, and the plan in the state court, contemplated there would be no interest paid for July 1, 1933, yet it is contended that because the District did not put that $320,000 in the Bond Fund, it is guilty of constructive fraud.

Judge Denman. What happened to that, was it spent?

Mr. Downey. No; I am glad your Honor spoke about that. There is no contention here that the District has been extravagant; there is no contention that it has squandered any of this money, or that it has spent this money for unlawful or improper purposes. Every dollar that we have been able to earn in that District from redemptions, or from power, or from assessments, has gone right into the General Fund of the District.

Judge Denman. That is not the question. I asked about the $320,000.

Mr. Downey. That has gone there, too.

Judge Denman. Has that been spent?

Mr. Downey. Well, it has all gone into the General Fund, your Honor. The bond fund has been non-existent since 1933. Money has come in and money has gone out of the General Fund and today the surplus which represents the excess of what we have been able to save over what we have been compelled to spend, is $1,500,000, so there it is; there is the $320,000 included as a part of the $1,500,000. If the $320,000 should go in the bond fund—which of course it would not if this plan is approved—there it is.

Now, nobody has ever claimed that we have operated on an extravagant basis; no one has ever claimed that we have taken the money and put it aside for improper purposes or spent it unnecessarily. It has been regarded as a trust fund. There it is. Maintenance has of course gone on. The District has, by economical operation, by reaching out for every dollar it is possible for the District to get hold of, built up its cash. If the bondholders are entitled to that $320,000, there it is. I made that statement in my brief. In their reply brief, appellants say: "But you did spend money for the Crocker-Huffman contracts." Of course. Those are contracts under which we are purchasing an encumbrance on our water rights (R. 511); without that purchase our underlying water rights would be jeopardized. Appellants say: "You did spend money for maintenance and operation." We did, obviously. If we didn't keep the District operating

the bondholders wouldn't have any security; there wouldn't be anything left for anybody. We are trying to keep the canals open and the farmers on the land in an attempt to service whatever may be the final bond issue here. All this was essential. So, also, was payment of bond obligations through January 1, 1933.

For eight years we have been under the scrutiny of the bondholders. We have filed annual reports and financial statements with the District Securities Commission, we have published financial statements annually as Section 14a of the California Irrigation District Act (Stats. 1917, p. 756) requires (R. 827-885). Engineers and bondholders have been down there and looked at our books. Appellants now say, eight years after this controversy arose, that in our balance sheet, Exhibit 26 (one of many financial exhibits), we have over-stated our liabilities and we have understated our assets. Now, may it please your Honors, that is based upon a triviality. It is not true in my opinion that Exhibit 26 is not correct; I think it is correct. We have an affidavit of a certified public accountant and others (Affidavit of Mr. Lumbard, R. 254 and see affidavits pp. 257-261)—it is a matter of bookkeeping. But anyway it is a triviality. Appellants take one exhibit, probably the least important exhibit in the case, Exhibit 26, a balance sheet. Of course, a balance sheet is supposed to show net worth. You don't ordinarily find balance sheets for the United States, or the State of California, or the Counties, because you don't show net worth as to them. It is not important. However, there was a balance sheet put in along with all of the other exhibits at the trial in November 1938.

In the other exhibits, and in the testimony, anything that any man could properly ask about finances is set forth clearly, but appellants take Exhibit 26, by itself alone, and they say, "You have over-stated your bond liability there by $387,000 principal."

Everybody that ever had a bond of the Merced Irrigation District knows that the bond principal is $16,190,000. In Exhibit 26 appears the entry, "Matured bonds $387,000," which appellants say—I don't know, I am not enough of an accountant to know—makes that balance sheet show that we have an accrued bond liability principal of $387,000 in excess of $16,190,000. It is negatived by every other exhibit and by every syllable of testimony. Then appellants say, "You over-stated your interest liabilities in that balance sheet." "How did we do that?" "Well, you say that you owed some $824,000 more in interest than you really did owe." "Why?" "Well, that represents the $824,000 you paid R. F. C. in interest." It should show as a credit on Exhibit 26. Whether that is a credit on the interest—the amount paid the R. F. C. is certainly a debatable question—but the absurdity of the thing is that no one ever disputed that that money was paid to the R. F. C., and the point I am now making is that whether the entry is right or wrong it could not have misled anyone. The payment appears over and over again in the District's testimony. It was an admitted fact (R. 369, 764).

Then, they say, "You didn't state all of your assets." "Why not?" "Well, you didn't include in this balance sheet (Ex. 26) which was prepared as of November 1938, the time of the trial, the asset resulting from the

levy of your assessment in 1938 for operations in 1939." We levy in September 1938 and we collect in December, and later on, to meet the obligations of 1939, and not having included the obligations of 1939, we did not include the tax levy—and, I think, very properly so. Now, it is from that sort of material, may it please the Court, that charges are made, and they are the only charges made of any lack of good faith on the part of the District; and I submit, your Honors, looking at the background of this plan, the method by which these negotiations have been conducted, that the District stands up for having been fair and honest, and for having attempted, and still attempting, to meet every dollar of its obligation that it can.

Judge Denman. We will take a five-minute recess.

(After recess:)

VALUE, MERCED DISTRICT BONDS.

Mr. Downey. I want to say a word, your Honors, as to the value of the bonds of the District. In the closing brief of Appellant (page 19) it is asserted that it is undisputed that there was a bid of 56 for the bonds of the Merced Irrigation District, February 5th, 1935, eight months before disbursement. That is not correct. The record shows (R. 521) that on February 5, 1935 there was a bid of 56 for the Merced Union High School District Bonds, not Irrigation District Bonds. On the other hand, the record is clear—there is no dispute about this —that the bonds of the Merced Irrigation District reached a low at the end of 1931, and during the year 1932, when they were as low as 16 cents on the dollar (R. 500). In

the spring of 1934, which was after we had made our application to the R. F. C. for a loan, they were selling at 28 cents, and they fluctuated between 28 and 32 cents until the fall of 1934, when the R. F. C. loan was granted, when they appreciated in four or five days to as high as 33 to 44 cents, and gradually increased up to 51½ cents when the R. F. C. commenced to buy up the bonds (R. 500). So that, notwithstanding the assertions in the reply brief of appellants and what I understood to be assertions in the Argument, here, the record is without conflict that the bonds of the District appreciated from at least 28 to 32 cents up to the settlement price, after the R. F. C. made this loan, and that they were as low as 16 to 18 cents before the loan was applied for.

LOS ANGELES LUMBER PRODUCTS COMPANY CASE.

Next, I come to the Los Angeles Lumber Products Company Case, which I want to speak on for a minute. Of course, we think that there are obvious distinctions between Chapter 9, which is a composition statute, and Section 77-B, which is a reorganization statute. That distinction is inherent in the terms. Composition is necessarily a cutting down, or scale down; reorganization is something quite different[5]. Mr. Justice Douglas,

5. Composition is a voluntary proceeding by which the debtor offers to pay his creditors a certain sum in exchange for a release and the amount offered may be even less than would be realized through distribution in bankruptcy. (*Cumberland Glass Mfg. Co. v. DeWitt*, 237 U. S. 447 at 452, 59 L. Ed. 1042 at 1045, 35 S. Ct. 636; *Nassau Smelting and Refining Works, Ltd. v. Brightwood Bronze Foundry Co.*, 265 U. S. 267 at 270, 68 L. Ed. 1013 at 1015, 44 S. Ct. 506.) The purpose is to enforce the will of the majority upon the minority and "except for this coercion * * * the intervention of a court of bankruptcy would hardly be necessary." (*Samuel A. Myers v. International Trust Co.* 273 U. S. 380, 71 L. Ed. 692 at 697, 47 S. Ct. 372 at 374.)

in the Los Angeles Case, in a footnote—which your Honors undoubtedly have read—calls attention to the fact that Section 77-B is not a composition statute at all, and reference is made to the fact that in 77-B the word "composition" does not appear. Conversely, if you turn to Chapter 9, you will find it is all composition, and the word "reorganization" does not appear. In Mr. Justice Hughes' Opinion in the *Bekins* Case, he stresses the composition feature of the Municipal Bankruptcy Act, and significantly, as we point out in our brief, the Supreme Court, on the very day it handed down the Los Angeles decision, denied certiorari in the case of *Luehrmann v. Drainage District No. 7,* 104 Fed. (2d) 696, which came up under the composition statute. In the *Luehrmann* Case, the scale-down as I remember, was from some hundred cents to 25 cents, and the only evidence, as you read the opinion, of fairness of the plan was the consent and the appreciation in value of the bonds. That was the first important—perhaps the only outstanding case involving the questions which we have before this Court to go to the United States Supreme Court in a way which would have called for a ruling on the legal principles relating to composition, had there been any basis for the contention that the composition statute is identical with Section 77-B.

Of course, however, we feel that even if the *Los Angeles* Case were applied in this case, so far as it is possible to apply the case to a different set-up, that we are still entitled—clearly entitled to an affirmance of this plan. Of course, when you start with the assumption that the creditors in a private corporation, as they are, are en-

titled to foreclose their obligations, to sell the assets, to reduce them to money and to divide up what is realized, it seems to follow that you can't cut the stockholders in until the creditors are paid. But we deal here with an entirely different agency. There is no right to take any of our property. If they did take it, they wouldn't know what to do with it, I am sure of that. The irrigation system has no value unless landowners who use it can farm their lands profitably.

Judge Denman. Wouldn't the Districts in which all the land has been bought in hold in trust for the bondholders?

Mr. Downey. Well, our Supreme Court held in the case of *El Camino Irr. Dist. v. El Camino Ld. Corp.,* 12 Cal. (2d) 378, 85 P. (2d) 123, that after the District had acquired the property it still could not be taken on execution by the bondholders, and in *Clough v. Compton-Delevan Irr. Dist.,* 12 Cal. (2) 385, 85 P. (2) 126, it held that the lands could not be partitioned. The Supreme Court certainly held that the land was held in trust but not alone for the bondholders. It held that the land was in trust for all the purposes of the Irrigation District Act, including operation of the district and payment to bondholders. In effect, the Court held that the only thing bondholders could get out of the property was the rentals after the amount required for operation had been taken out.

Judge Denman. Then your argument is that that might very well be worth less to the bondholders than the 51 per cent?

Mr. Downey. Unquestionably, that is true.

Judge Denman. But you can't get the analogy between that and a bond which is a lien directly upon the property, and you can't foreclose directly as you can in the street assessment districts.

Mr. Downey. Not only that, your Honor, but we must bear in mind that all of these irrigation district lands are also subject to other public obligations. They are subject to taxes, and they are often subject to improvement district liens of one kind or another, so what actually happens in practice is that whenever the *lands* begin to go delinquent, they probably default not only in the irrigation assessments but in their taxes, and other obligations. We have agencies that have four or five or six tax titles. The property will be deeded to the State for delinquent taxes; property will be deeded to a reclamation district for delinquent reclamation assessments, and to the irrigation district for delinquent irrigation assessments; and we get into a mess that is well-nigh impossible to unscramble.

Judge Denman. Let's see if I can follow you in my mind. Your answer to the statement of your opponent that because the value of the land is greater than the value of the 51 cents, therefore there ought to be a higher amount, and this is unfair because of that, your answer is that they have no lien on the land; that when you determine the value of the land it is not its free value, but its value as impaired by other tax liens and tax obligations, and when you come to view it from that standpoint, the court was within its discretion in deciding that it was less than the 51 cents. Is that the summary of your argument?

Mr. Downey. That is correct, your Honor; it doesn't go quite as far as I go, but that is one point upon which I rely.

Judge Denman. How much further do you go?

Mr. Downey. I go this much further: that it is utterly impossible to have market value in an irrigation district which is encumbered by a bond issue in excess of the ability of the lands to pay.

Judge Denman. This assumes cleaning up and taking over the land. The question as presented by your opponents is: assuming now that it is cleaned up, so far as the processes of the irrigation district may do so, will it at the end of that time be worth more than 51 cents to these people? You can't have your cake and eat it, too. You can't say this thing is going to remain there. If you clean it up and the lien no longer remains, will what you get out of it be worth more than 51 cents? I have tried to summarize what they say.

Mr. Downey. I think that is a fair summary, your Honor, except the converse is also true: once you put the district on an ability-to-pay basis, then your lands have value. According to the Cone report they are worth about $10,000,000 (Ex. 35, p. 128). Once you exceed the ability to pay, they don't have any value; so, I say to your Honors, in an irrigation district, the question to be determined is: what is the ability to pay? We will concede that we must offer in court a plan which is based on ability to pay. If we do that, then all of the other factors go out of the case.

Judge Denman. Suppose somebody suggested a plan on the basis of ability to pay——

Mr. Downey. Yes, your Honor.

Judge Denman (continuing). What you have got to do is to show that your plan is the best that can be taken, stretching your ability to pay to the limit. That is your position, Mr. Downey?

Mr. Downey. I think that is a fair statement of it, your Honor, and that is what we have attempted to do here. Of course, let me say this: that no two persons, no two bankers, no two underwriters would ever agree to the cent as to what any irrigation district would pay. There is no exact yardstick to determine ability to pay. And in the last analysis it must rest upon a finding that the plan is fair. The exact quantum is impossible to ascertain. It is an inference of fact drawn by the trial judge.

Judge Denman. That is the reason I tried to get your opponent to state what he thought the character of the evidence was; whether the evidence presented to the lower court an area in which it had a discretionary judgment as to values. I am not quite certain what their position was on that.

Mr. Downey. I am sure I don't know, your Honor. They said—these were their words: the "finding on fairness disappeared" from this case for some reason. And they said that the finding was entitled to a "mere presumption" of fairness. That this proceeding here is a "trial *de novo*" on fairness.

FINDINGS STAND UNLESS CLEARLY ERRONEOUS.

Now, may it please your Honors, this court in the past few months has decided in at least four recent cases

(*Anglo California National Bank of San Francisco v. Lazard et al.*, 106 F. (2d) 693; *Western Union Telegraph Co. v. Nester*, 106 F. (2d) 587; *Cherry-Burrell Co. et al. v. Thatcher*, 107 Fed. (2d) 65 and *Occidental Life Insurance Company v. Thomas*, 107 F. (2d) 876) that under Section 52 of the new Rules of Civil Procedure the findings of the trial court stand unless they are clearly erroneous. And that if different inferences may be drawn from the testimony, the inference drawn by the trial court will be upheld unless no reasonable man could draw such inference. And it has held that this court will not weigh the evidence. The weight of evidence is for the trial judge. And going back a little further, I remember a case in which Judge Wilbur said, in effect, that the findings of the trial court are conclusive if there is any evidence to sustain them "it matters not how convincing the argument that upon the evidence the findings should have been different" (*Ocean Accident & Guaranty Corporation v. Ethel Rubin, et al.*, 73 F. (2d) 157).[6]

We have a finding here—and I might state to your Honors that aside from the legal points, it seemed to me the argument of counsel for appellants was simply an argument on the facts, and if you will turn to the briefs you will find it is only in the closing brief of appellants that they really go into the question of fairness in detail.

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6. Even if incompetent evidence is considered by a trial court, the question still is: is the evidence sufficient to support the findings eliminating the incompetent evidence? (*National Ben-Franklin Insurance Company v. Stuckey*, 86 Fed. (2d) 175, at 176; *United States v. Blumenthal*, 77 Fed. (2d) 219 at 221. In the notes of the Advisory Committee on the new rules of Civil Procedure, speaking of Rule 52 and the provision that findings of fact shall not be set aside unless clearly erroneous, the Committee says: "* * * It is applicable to all classes of findings in cases tried without a jury whether the finding is of a fact concerning which there was conflict of testimony, or of a fact deduced or inferred from uncontradicted testimony." (U.S.C.A. Title 28 under authority of Secs. 723b and 723c.)

I don't mean unfairness is not suggested, but really, the closing brief of appellants is the first time they undertake to point out in detail what they think the district could pay, and they first say $14,500,000, then they get so enthusiastic that they say "You should pay $20,000,000, notwithstanding you went into utter collapse at $16,000,000". It would have seemed that if this plan were unfair, if we were not paying what the district was able to pay, they would have shown in the testimony that this underwriter or this bank or this group would be glad to finance that district at an amount in excess of $8,000,000; not a word of that kind is in the evidence. As a matter of fact, your Honors, the evidence of fairness in this case rests almost entirely upon our testimony. I don't know what they put in that tended to show the plan was unfair. There is an analysis of the plan in their closing brief and of our revenue and income that I want to take up. It is really this analysis of our income in their closing brief, and here, and of the Benedict report in their closing brief, and here, upon which their position rests.

POWER REVENUE—$400,000 NET.

Now, this district does have a substantial power income. If it did not have, we would not have received 50 cents from the R. F. C., and, as I said a little earlier, we tried to—we contended there that we could get $500,000 a year from our power. However, based on our experience, it doesn't hold up. If we take the run-off records of the Merced River going back to 1872 and figure out theoretically, if that water had been run through our power plant

in those years, what it would have produced—the engineers get a figure somewhere around $500,000.[7] Based on actual experience, we find that we don't get that. The district has been operating the power plant since 1926, and, based on the actual yield we gross $444,000 a year (R. 407). Now, again that we have operation expenses at the power plant, amounting to about $22,000 annually (R. 407) and there is a depreciation—and it is a very real depreciation, not a bookkeeping depreciation, on the plant of about $22,000 more (R. 408); so that conservatively, we have to estimate our net power yield at $400,000.

Now, Mr. Childers said, "Well, it is uncontradicted that, based on the run-off of the past you should get $500,000" —or whatever the figure was. They contend it is in excess of $500,000. Well, it is one thing to operate a power plant faced with the problems that the operator has to face every day, and it is another thing to work it out on paper. It is like the Monday morning quarterback diagnosing the plays that should have been made on the preceding Saturday. Right today we have a substantial amount of water in our reservoir as a result of the recent rains. We also know to some extent what the snow conditions are in the mountains, but we can't know that very accurately. Now, should we open our plant today, or not? Well, your operator has to decide whether if he starts the plant running today he is taking a chance—if we run into a dry period the next two or three months—of coming to the irrigation season without any water.

7. Thebo, Starr and Anderton made a report for the bondholders in April or May, 1931, indicating power revenue of $500,000 per year. Before August they revised that figure to $450,000 per year gross (R. 496).

Now, if he does not do it, there may be a big spill later on, and there will be water wasted that we could have run through the plant. On the other hand, if the operator starts his plant and we don't get the water that is expected, then we face the calamity of running through the irrigation season without any water. Again there may be lots of snow in the mountains and we may get a week of warm rain and it all may come down at once and a lot of it therefore spilled and wasted. Run-off enters into the problem and time of storms and temperature and many other things. Here is the laughable thing about this situation: Appellants call two outstanding engineers, splendid men, high-standing men, Mr. Heinze and Mr. Hill. They both testify they have gone over these run-off records and that we can get $500,000. Mr. Hill, however, in 1924 had made a report on the power income the district could expect to get at a time when bonds were being sold and prospective bondholders and landowners were vitally concerned with power income. In his report made in 1924 Mr. Hill found, based on the run-off records of the past, that the district power income under no circumstances would ever go below $300,000 a year (R. 536-538). Well, as a matter of fact since 1923, we have had three years that have been under $300,000 (1929-1931-1934, R. 671-676) and one year when we only made $95,000. That is the difference between the theoretical concept and the reality.

Now, the court held that the yield in the last two years preceding the trial was—I think he used the term "providential". It was providential. We had a yield over $700,000 in 1938, and something over $600,000 in

1937. Obviously the trial judge placed the income so far as power was concerned on an actual yield basis.

Judge Stephens. Mr. Downey, are you speaking of net return or gross?

Mr. Downey. When I say $400,000 I mean net; the gross return is $444,000.

Judge Stephens. You just said something about 700.

Mr. Downey. Well, that is gross, your Honor.

Judge Stephens. And the percentage, of course, would be about the same.

Mr. Downey. No, I think the operation cost is about the same.

Judge Denman. There is no variation in your overhead on that?

Mr. Downey. Very little, I would say; practically none.

OPERATION AND MAINTENANCE—$500,000.

Now, we start with an assured income of $400,000 net power, let us say, according to our figures, then we have to operate. Now, the testimony on operation and maintenance was this—not contradicted—that ordinary operation and maintenance is $375,000 a year (R. 513). If we actually carry out the deferred maintenance and the capital expenditures that are absolutely imperative in the district, it is $125,000 more, or $500,000 a year (R. 513). Now, we have this picture down there: You get more money, we will say, from the power. That means more water. You run into high water conditions. The ground water rises; we have to open our channels to run the water out; we have to install drainage wells to take care

of the water, and it does not by any means follow because you are getting more power that you are actually getting more net money. I am not speaking of power house operation, but the general operation, the control of floods, the control of ground water.

Judge Denman. Are your facilities for disposing of your drainage permanent or temporary? When the occasion arises, such as a flood, have you got some pumps as a permanent installation?

Mr. Downey. We have practically no flood protection there at all. We do have protection to a certain extent against the seepage from our canals. We try to line our canals but we have not been able to do that to the extent we should. It is a progressive policy of lining we are pursuing. There are many canals which we have not been able to line, and which we have got to line otherwise the damage done by the canals, by seepage, will result in tremendous loss; then we have tried to control the ground water by drainage pumps, and we have not been able to put in enough of them. In other words, the conditions so far as control of water is concerned have to a large extent been deferred, because we have not had the money to spend. We have been operating practically as a bankrupt for six or seven years, and we are vitally in need, not merely we, but our bondholders, because they don't get anything if we don't get anything. We are vitally in need of capital improvements, and deferred maintenance money —this is the only testimony in the case: $500,000. So that, so far as the power income is concerned, on our figures, we still need $100,000 to meet operation. If we took all of the power on their figures we would be about even.

ASSESSMENT YIELD AT $4.00 PER HUNDRED. NO DELINQUENCY—$480,000.

Now, then, what is the situation with respect to assessments? We have been levying $3 a hundred—it is not an acre charge—they speak of it as $1.75 an acre average which is very deceptive. It is $3 a hundred. We can't figure these things on *flats*. $3 a hundred is the emergency rate we have been levying. If we could restore all of our land to the tax roll we would have about $12,000,000, according to our books, and if we levy a $4 rate —remember, we have not been servicing a portion of our bonds, because they have been tied up in this litigation or some similar litigation—if we could get every dollar of land back on the tax roll 100% and if we levied a $4 rate, that would bring us in, if there wasn't any delinquency at all, $480,000 a year. Taking our figures, $400,000 on power, and a $4 tax rate, $480,000, without a penny of delinquency, we should have a total income of $880,000.

SERVICE OF R. F. C. BONDS—$435,000.

Now, to service the bond issue to the R. F. C. costs $435,000 annually after all dissenting bonds are in. If all these bonds were in and the R. F. C. took our refunding bonds, the service charge would be $435,000 a year. So that, taking the $435,000, plus $500,000 for maintenance, we get $935,000 that we are required to meet annually as against the income of $880,000 on a $4 tax rate.

Whether we will be able to operate on a $4 tax rate successfully—we don't know; there is a slight margain there; we may have to go a little above; we hope to go

a little below; we should, in order to compete successfully, and to really carry our bond issue, have about a $3 tax rate, which is about the rate of the two districts that I spoke of this morning, Turlock and Modesto, which are directly in competition with us. Remember, we have got to subdivide; we have got to colonize; we have got to sell our lands, and we can't sell our lands if Turlock, immediately adjoining us, and Modesto, immediately adjoining Turlock, are offering the same grade of lands, the same type of crop, and only paying a tax rate of $3, while we have to pay $4, $5, $6, $7 or $8—that aside from the question of ability to pay. There has been no real development or subdivision in the District since its formation.

Judge Denman. You don't want us to consider the question, do you, whether or not it is unfair to the landowner because 51 is too high?

Mr. Downey. Your Honor, that same question was asked Dr. Benedict in 1936 when he was on the stand. I remember Judge Cosgrave asked him that question, and this is what he said—this is the record, page 471:

> "Had this survey been made back in 1919"—I interpolate there the remark that at that time the Agricultural Index was over 200. Now I am quoting from Dr. Benedict—"and the survey showed that it did at this other time, I would feel that the formation of this district of improvements, the building of the dam, the storage of the water, was an impractical proposition. It is true, I think, that costs are being somewhat reduced from what they were in the period when this survey was made. Costs move somewhat more slowly than prices of products do. *It will depend upon this condition whether or not the new bonds"*—that is the R. F. C. bonds—*"will be as much a failure as the old ones."*

And Dr. Benedict also said in 1936:

> "If general economic and farming conditions come back, in fairly good condition in the next few years, I still would not expect these large holdings to be broken up more or less, and additional development take place in this District, because there has been a very pronounced change in the general situation affecting a great many of the California specialty crops and many of the major fruits of the United States, growing out of, in large part, a sharply reversed world situation. Many of these products depend to some extent on export markets, and those markets have been very sharply curtailed in recent years, and there is no present indication of very much improvement for a considerable time to come (R. 462).

All business, including agriculture, has improved somewhat since 1933. If we assume that agriculture and other business conditions come back to a condition similar to 1910-1914, or any other period, we may select, materially above what it is now, many of the indications of my report would still apply. The best estimates that the United States Department of Agriculture has been able to make are that, without some form of curtailment in many lines of production, that we must squeeze out of production variously estimated amounts of land—from 25 to 50 million acres in the United States; that is bound to be a depressing influence for a very considerable time, possibly 10 to 20 years, if that is the procedure with results. The agricultural adjustment program was, of course, designed to ease that transition. That has been eliminated for the present, at least. What future developments will be is very difficult to determine at this time.

It is my opinion there is no prospect of a sharp rise in agricultural prices. By a sharp rise I mean

such an increase as we had during the period from 1915 to 1919; during war conditions. I would expect a rise equal to the 1930 prices. I do not think it would go above that."

I have to refer repeatedly in this argument to the Benedict Report because appellants in their reply brief, for the first time, made an attack upon that report.

I assure your Honors that the R. F. C., in my judgment, made a loan here which no private banker and no private underwriter would have done. I think we can pay out, your Honors, but the margin of safety is not great. I know too much about the danger of hitting a tax rate that gets a little high; it results in a delinquency. You have to levy a higher tax the next year to make up that delinquency, and your assessments begin to pile up, and up, and up, until they reach a point where nobody can pay; and I cite in my brief a situation in the Acquisition and Improvement District No. 36 in San Diego County where this year they now have a tax rate, by a process of pyramiding delinquencies, of $28,000 per hundred dollars of assessed valuation. In other words, if land had an assessed valuation of $10,000 it would be assessed $28,000,000. This sort of thing inevitably happens, perhaps not on as fantastic a scale as that, once a point is reached where the ability to pay is exceeded.

Now, taking the income as contended for by appellants in their reply brief which they assert could carry a bond issue of $14,000,000, their power income is $100,000 too high, based on this theoretical study rather than actual yield; their operation is $100,000 too little, because they are taking the actual operation for the last few years

as against the fact that the record shows we will have to spend $500,000; and then they pick up $100,000 a year in the tax redemptions. I called your Honors' attention to that when I read the bondholders' committee letter to you, that at that time there was over a million dollars in delinquencies. It is that money which has been coming in in the last four or five years, based undoubtedly on fresh loans and new encouragement, together with the high power yield, which has given us a favorable showing today. Appellants count the hundred thousand dollars a year coming in, but that money doesn't come in both as a tax and as a delinquency; you don't make more money out of it by calling it a delinquent tax or a redemption. My figures are predicated upon the assumption that we have a $4 tax rate, and every acre pays—there isn't a cent of delinquency—at a $4 tax rate, that will bring us in $480,000. Now, the money that has come in on redemptions is largely past. There is still some delinquent money that we hope to get in, but if this plan goes through our plan is to try immediately to get all of the balance of the land restored to the assessment roll. We want, with the consent of the R. F. C., to exclude a lot of land where the service is at a loss, and if we do that and are able to hold a $4 tax rate, and if we can carry a $4 tax rate, and we don't run into a long period of drought on our power, or floods or breakdowns in our plant we will get along; but to talk about this District servicing $14,000,000 is just about as sensible as talking about servicing $20,000,000, and counsel conceded that because, having worked it out with pencil and a piece of paper at fourteen million, they say, "Why not twenty

million?''. Notwithstanding what the experience of the past has shown.

Now, one thing that may be effective in this argument on the facts from the other side—in their reply brief they say your Honors have the record before you in the *Palo Verde* Case. They say: In Palo Verde the better lands are going to pay $5.50 per hundred. ''Well,'' they say, ''look at Palo Verde. That isn't half as good as Merced. They figure ours at $1.75 an acre, we can't figure it on an acreage basis.'' It is fallacious to do so. They say, ''It can't be fair''—the Merced rate.

Now, if your Honors please, there isn't a syllable of testimony in the Merced record on Palo Verde or any other district, except Turlock and Modesto, which are competitors. In the second place, if you were to make a comparison between districts it would have to be done with the most careful analysis. You can't compare a district down near San Diego and on the Arizona border with a district up in the San Joaquin Valley; there are too many variables. First, the question of climate, growing season, and *crop* yield. I understand, for example, in Palo Verde they have a lot of alfalfa, and a much longer growing season; they probably have several more cuttings than we do in alfalfa alone. You have to go into the question of prices on specialty crops, what are the labor costs and what are the material costs, and what is the proximity to market, and all that sort of thing. There are probably a dozen or more essential variables in connection with these irrigation districts, and not only do I consider it unfair, in their closing brief, to bring up a case like that, that we have never even had a chance to cross-examine

witnesses about—with respect to which there is not a single syllable of testimony—but, obviously, you can't compare those kinds of districts, and it should not be put forward by counsel as ground for the contention that it has any bearing on the Merced District.

Some similar remark was made about the Corcoran District, and the Lindsay-Strathmore, which is a citrus district. So, it comes to this: Every district has its own problems. It is a question of yields and water service, and all the other things which necessarily enter into the question of cost and ability to pay.

Now, your Honors, I have been talking a long time. I thought if I worked over this I would be able to cut it down. I would like to address myself very briefly to the question of the R. F. C. status, and Section 52. Mr. Shaw and Mr. Knupp will wish to talk, and they are going to talk particularly on the jurisdictional questions advanced by Mr. Childers, and also on these others—I think in a few minutes perhaps I can cover those two points, but I find that I take longer than I hope to.

STATUS OF R. F. C.

Now, first, on the status of the R. F. C., we start with the principle that in composition cases the debtor can go out and borrow money on his own terms and use his security to effect a composition. *Zavelo v. Reeves,* 227 U. S. 625, 33 Sup. Ct. 365, 57 L. Ed. 676, cited in my brief, and decided by the United States Supreme Court, establishes that. And there is no contention that under

the law of California we don't have the right to borrow money to refinance our debt.

Judge Mathews. What is the name of the case you just cited?

Mr. Downey. *Zavelo v. Reeves;* it is cited in my brief, your Honor (spelling) Z-a-v-e-l-o.

Judge Mathews. I have it.

Mr. Downey. Now, in our brief we show that every contract made with the R. F. C.—there are two of them, one in September, 1935 (Ex. OO, p. 202) and one in August of 1935 (Ex. OO, p. 217)—and every resolution passed by the R. F. C. and accepted by our district, expressly stipulated that the old bonds should be maintained alive as outstanding obligations in order to assure parity and for other purposes. Now, in the reply brief it is suggested for the first time that the controlling contract is the contract of September 16, 1935. That is Exhibit 8; it is in Exhibit "OO", page 202. That is the last contract. The first resolution was November, 1934 (Ex. OO, p. 155), authorizing the loan, then in August, 1935, just before the disbursement, there is a contract which we think is intended to cover the disbursement, itself (Ex. OO, p. 217), and then in September there is a contract for the purchase of the refunding bonds (Ex. OO, p. 202). Now, it is asserted dogmatically in the reply brief, first, that this contract of September 16, 1935 throws the August contract out of the picture, as a later contract, and, secondly, that in this contract of September 16, 1935, the R. F. C. gives a firm agreement to purchase up to $8,600,000 of refunding bonds and to turn in the old bonds at $51.50—that is the settlement rate.

Now, that is wrong on every count. In the first place, all of these contracts have to be considered together. They are practically contemporaneous documents. But, passing that point, if we take this agreement of September 16, 1935 and stand on it alone, this is what we find: First, in paragraph 10, it is expressly provided that the R. F. C. must be—and I quote—

> "satisfied as to all legal matters and proceedings affecting the bonds and the security thereof, otherwise the R. F. C. shall not be under obligation to purchase any of said bonds".

There is a clause which provides that the old bonds are to continue as outstanding obligations; there is a clause which provides that the district is required to carry out the obligations which it assumed upon its acceptance of the original resolution of November 14, 1934, and if we turn back to that resolution, your Honors, to find out what the situation is, we find it stated over and over again that the district is obligated to service the old bonds, to regard them as outstanding for the full face amount thereof. Now appellants say that under the last contract (Ex. OO, p. 202) the R. F. C. is obligated to turn in the old bonds, no matter how many of them they have, at $51.50. But if we turn to the resolution of November 14, 1934, which is incorporated in that contract, we find this: I am reading from page 163, "OO":

> "The Division Chief * * * may require the borrower to duly execute or agree to execute such amount of its new 4 per cent bonds as they may specify, and when executed, to deliver such bonds to a trustee or custodian * * *"

Such trustee shall be—I quote—

> "irrevocably bound to exchange new bonds for a like or greater principal amount of the old securities".

In other words, the R. F. C. could say to us, "You give us eight million dollars of refunding bonds, under that clause, and we will give you eight million dollars of old bonds", which leaves still the differential of eight million dollars in their favor. These provisions are necessary to insure parity.

Now, may it please the Court, I have gone over these documents again, and again, and again, and discussed them. We have all discussed them. The R. F. C. has discussed them with us; and this contract is perfectly plain, if we just take the contract. The difficulty comes here from attaching some kind of a label to it and then trying, as I said in my brief, to pour it into some kind of a legal mold; but the contract, itself, is clear. This is all it is: The R. F. C. says to us: We will loan you $8,600,000 to refinance your debt. Now, you are to go ahead and to get your securities available for refinancing. "When we get ready—good and ready—when we are satisfied, we will buy your refunding bonds, and then we will make the exchange. Now, in the meantime we will go out and buy up those bonds and hold them". There is nothing wrong in that; anybody, any of these appellants, could have gone out and bought up district bonds at that figure, or any other figure. They could have gotten them at less and held them. They are not hurt by that; and not only do the cases cited in our brief say this is a common situation in reorganization proceedings, but they go far beyond——

Judge Denman (interrupting). Are you now arguing that there is not a loan to the district for the purpose of enabling the district to buy the bonds in?

Mr. Downey. No, not to enable the district to buy in the bonds; it is loaned to the district on condition that it will make available its securities for refinancing and insure parity.

Judge Denman. Do you or don't you contend or admit and agree that the R. F. C. is the agent of its borrower in procuring the securities for the purpose of the whole refinancing?

Mr. Downey. I don't think it is the agent of the district, your Honor.

Judge Denman. Whose funds are there on deposit that are paid out for these bonds?

Mr. Downey. The R. F. C. has merely authorized the Federal Reserve Bank to buy for its account any bonds of the Merced Irrigation District which are presented at the price of $51.50. That is all there is, so far as the R. F. C. and the Federal Reserve Bank are concerned.

Judge Denman. I mean as between the district and the R. F. C., is it your contention that the money is not borrowed, at all? That they don't owe anything, or is it your contention the money has been borrowed and you are paying interest on it, and it has been used to buy in the bonds for your account? If you have not borrowed the money, if the R. F. C. is simply buying these for themselves, how are you going to pay all this interest?

Mr. Downey. We have agreed with the R. F. C. that if they will buy up our bonds and make them available for refinancing we will pay them 4 per cent on that price, with the understanding that when they have bought up

all of our bonds or we have brought them in to them so they can buy them up, they will then exchange those bonds for our refunding bonds. It is an interim arrangement at the present time.

Judge Denman. You don't think, then, that the bonds that are surrendered are going to be surrendered in cancellation of the existing debt?

Mr. Downey. They certainly are not at the present time, your Honor. Not until refinancing is complete.

Judge Denman. I mean those surrendered now. When the old bonds are surrendered, do you not expect a settlement then of the loan that has been going on in the interim, in the form of a new bond?

Mr. Downey. Most assuredly, when it is completed.

Judge Mathews. What is the amount of this loan?

Mr. Downey. The amount used by the R. F. C. to buy up the bonds is approximately $7,500,000, with which they purchased nearly $15,000,000 in bonds.

Judge Denman. You say your position is that the R. F. C., as an independent entrepreneur, is going to buy up a lot of bonds when the district says, "We will pay you interest on the amount you spend to buy up our bonds, and after it is all over and they are all in, then we will convert this thing into a sale of bonds to *us.*" Is that the position you take?

Mr. Downey. Your Honor, that is a perfectly proper position.

Judge Denman. How do you get all those words of "loan" all the way through the transaction?

Mr. Downey. It is a conditional loan; the conditions have not been complied with. Yes, your Honor, if I understand you now there isn't any question but that

subject to certain conditions the R. F. C. has made a loan. Now, those conditions are not complied with until after we have made available the old securities for refinancing, or until the R. F. C.——

Judge Denman (interrupting). Suppose you don't do that? Suppose you don't do that? Don't you owe them any money? If you don't carry out all those conditions, don't you owe them any money?

Mr. Downey. They naturally could enforce the bonds and get back the amount they have used to purchase the bonds, but, on the other hand, we couldn't go to the R. F. C. tomorrow and demand that they accept our refunding bonds. We couldn't go to the R. F. C. and say, "Our refinancing is complete, and we demand of you today that you give us the old bonds and we will give you the refunding bonds". We wouldn't get anywhere on that basis, because there is nothing in the contract which obligates the R. F. C. to take our refunding bonds until they are satisfied that the refinancing is complete.

Judge Denman. The R. F. C. is not going to take a lot of new bonds with the prior issue outstanding. What they want to do is what anyone would do, to have a perfectly clean single obligation in the new bonds. But isn't that what is really said in that last contract?

Mr. Downey. Well, I think that is, your Honor.

Judge Denman. I mean to say: I am not willing to accept a second bond issue with everything outstanding prior to it. The last contract refers to that. They want to know what any lender would want to know: that there is nothing outstanding in the way of a prior lien; but I had difficulty in following your argument that you were not borrowing any money at the present time.

Mr. Downey. I say we have had a loan on condition, the conditions of which have not been fulfilled,——

Judge Mathews (interrupting). You can't postpone a contract to make a loan; but your contract is not yet an executed contract.

Mr. Downey. That is correct.

Judge Stephens. The district has not received any money it could use as yet?

Mr. Downey. That is correct.

Judge Denman. Then all this money you have been paying is by way of an option, and all the interest money is interest on the loan which is represented by the option to do something in the future, according to your theory?

Mr. Downey. Your Honor, it is paid because it is for the benefit of the district to pay it. That is to say, the R. F. C. says to us, "We will go out and buy up these bonds, but you have got to pay us 4 per cent on the amount we use for that purpose". Now, we are benefited by that.

Judge Stephens. How?

Mr. Downey. Well, we are benefited because it is an essential element in the consummation of the plan that they should do it that way. We haven't got the money to do it, ourselves; we have no money.

Judge Stephens. How does that cut down on the total debt?

Mr. Downey. It doesn't cut down on the total debt until such time as they have been able to buy them all in.

Judge Stephens. How does that operate? I thought I understood it, but I have become a little confused the last few minutes.

Mr. Downey. The 4 per cent that the district pays, it pays for the benefit that accrues to it in having the R. F. C. buy the bonds. Now, if we don't consummate this transaction, we believe under the contract that the 4 per cent would then be credited against the interest on the bonds which the R. F. C. holds.

Judge Stephens. If this doesn't go through, you will pay out twice as much?

Mr. Downey. That is correct. We throw ourselves on the mercy of the R. F. C.

Judge Mathews. This 4 per cent is not at the present time regarded as bond interest, but is the stipulated interest on the amounts the R. F. C. has advanced or used to purchase the bonds with?

Mr. Downey. That is correct.

Judge Mathews (continuing). Which is less than the bond interest would be?

Mr. Downey. That is correct. They could collect bond interest, but they have stipulated they won't. The 4 per cent is for the use of new money poured into a bankrupt district.

Judge Mathews. When you speak of the amount due on a loan, you mean the amount so far invested by the R. F. C. in these old bonds?

Mr. Downey. That is right.

Judge Stephens. But you are paying 4 per cent on the bonds the R. F. C. has taken up, and nothing on the other old bonds?

Mr. Downey. That is correct, your Honor. We are paying 4 per cent on the money advanced by the R. F. C. to buy the bonds.

Judge Denman. Frankly, I don't agree with you, at all. My conception of that thing is that what they have done is just what they said they did. That is to say: I have some money; I will lend it to you, and as your agent I will buy some bonds in, and when it reaches a certain point I will stop and I will turn them all over to you—I will not hold them as security; I will turn them all over to you and take some new bonds. That is the way that contract looks to me, to be perfectly frank with you; it seems to me it is the ordinary business transaction, that the maintenance of the parity, if it is done, is just what is customarily done, and that those bonds have a parity of interest in this proceeding. But I can't see it as an agreement in which—for an option or a future acquisition of the bonds, if you have been paying this interest all this time. I can't see anything in it except paying interest on a debt—a loan which the lender has made to you or put in the bank, or left credit in the bank—if it has bought for you some bonds. I say this so you will get my own viewpoint on it. Each one of us has got to have a conviction about your case, but it seems to me, as I see it now, that if you can show that there is a proper agreement for the maintenance of parity customary in such refunding transactions, that you convince me on this end of your case, but not on the basis of being an option on which you pay an interest rate monthly.

Mr. Downey. I didn't intend to call it an option, your Honor.

Judge Denman. It is either an option or a loan. If you are buying the contract or paying a monthly amount of consideration for a future contract, it is interest on a loan.

Mr. Downey. I wouldn't attempt to take opposition to your Honor's statement; I think it is substantially correct. It seems to me that such difference, if there is any here, is a difference in the minutiae of the thing; that I don't perhaps follow, or perhaps your Honor does not follow me, which I don't wonder at under the circumstances. I venture this assertion: that anybody who picks up that resolution of November 14, 1934 and those two contracts, and then considers the transaction at the time the money was actually disbursed, when the R. F. C. took bills of sale to those bonds, would come to one conclusion. That is, that the bonds are outstanding and provable in this case, and they are here for the purpose of establishing parity among all the bondholders. Mr. Shaw and Mr. Knupp were going to talk further about this point. I wanted to talk very briefly about Section 52; that is the *Bates v. McHenry* rule. I think I can cover it in seven minutes.

Judge Denman. Go ahead.

SECTION 52 AND BATES v. McHENRY.

Mr. Downey. This is the contention of our opponents on Section 52, *Bates v. McHenry:* They say that that case —*Bates v. McHenry,* 123 Cal. App. 81, 10 Pac. (2d) 1038, held that the bondholders should be paid in the order of their presentation; that they have some kind of a preferred right or lien, if they are such registered bondholders, to the extent anyway that there is money in the fund—in the case of the Merced Irrigation District, there is a million five hundred thousand dollars there.

And they claim that the bondholders who first presented their bonds for payment and had them registered, would be entitled to have all of that million and a half dollars, leaving the other bondholders to get what they could, if anything. They say that is the rule of *Bates v. McHenry;* and if you follow through that case, you do find that the Supreme Court has said over and over again that the bondholders in an irrigation district are entitled to be paid in the order of their presentation; it sounds plausible. However, *Bates v. McHenry* undoubtedly construes Section 52 of the Irrigation District Act, providing for the payments, as merely establishing an orderly procedure of payment and putting all bondholders on a parity in a solvent district because the basis of that decision is that the bondholder who comes in and gets the money gets cash, and the bondholder who can't get money because the fund is temporarily exhausted, registers his bond and gets 7 per cent interest. One gets the cash immediately and the other gets the cash in time plus 7 per cent for the deferred period. In other words, the statute obviously contemplates a solvent district, and the rule is merely one of orderly disbursement in such solvent district. It is a rule of parity and equal treatment among all bondholders.

Now the *Merced* District, at that time was not regarded as insolvent, at least the question of bankruptcy was not involved, and as a matter of fact, it did pay the money, so that all bondholders got their money for that particular interest date. Mr. Justice Plummer, in that opinion, points out that there is a clear distinction between the provisions for payment of bonds and interest coupons

under the Irrigation District Laws of the State, and the marshaling of assets to make payment on the bonds of an insolvent concern or where there is only one fund out of which payment can be made. Bankruptcy or insolvency of the irrigation district would therefore raise entirely different considerations. Following the *Bates v. McHenry* case we have *Selby v. Oakdale Irrigation District,* 140 Cal. App. 171, 35 P. (2d) 125, which Mr. Cook referred to yesterday, where again the rule was invoked by the court not to *give* a preference—as appellants contend should be given—but to *prevent* a preference. There, the Oakdale District had levied a tax to service its refunding bonds, and had attempted to pay them off to the exclusion of the old bonds. Mr. Justice Plummer says you can't do that; you have to pay in the order of presentation to prevent a preference. There was no question of bankruptcy there. Why should holders of the refunding bonds be favored as against the registered bondholders?

The next irrigation district case was the case cited by Mr. Cook (*Shouse v. Quinley,* 3 Cal. (2d) 357, 45 P. (2d) 701) where the legislature passed an act providing that landowners who held bonds could pay their assessments in bonds. This law was set aside on the obvious ground it impairs the contract, and because the court says it gives a preference to the landowner who is a bondholder, and that can't be done either. It says the money must be paid to the bondholders in the order of presentation. You can't give the landowner a preference over registered bondholders by permitting him to pay his assessment in bonds. If you do, he gets paid ahead of the registered bondholders.

Turning to the reclamation district cases which cite *Bates v. McHenry,* we find they proceed upon the theory that because in reclamation districts there is not an inexhaustible power of taxation as there is in irrigation districts, the fund is not replenishable and, in the event of shortage, money must be prorated. In *Rohwer v. Gibson,* 126 Cal. App. 707, 14 P. (2d) 1051, involving a reclamation district, Mr. Justice Plummer says there it is different from an irrigation district; the irrigation district fund is replenishable but the reclamation district fund is not replenishable, and, therefore, the money must be prorated in the event the fund is short. Then follows a group of reclamation district cases following *Rohwer v. Gibson,*[8] in all of which it was held the funds were to be prorated.

Now, there is a third class of cases which cite *Bates v. McHenry,* namely, the Road Improvement District cases. The Supreme Court of this State, in *Kerr Glass Manufacturing Co. v. City of San Buenaventura,* 7 Cal. (2d) 701, 62 P. (2d) 583, had a case where insufficient money had come into the fund to meet the bond obligations. There was a limited power of general taxation behind the bonds in addition to the assessment; it was not however inexhaustible. The Supreme Court in that case said the money would have to be prorated, citing the *Port of Astoria* case. In the *Port of Astoria* case (15 P. (2d) 385) the Supreme Court of Oregon held that if there is an inexhaustible power of taxation, but as a matter of fact

8. *Kimball v. Hastings Rec. Dist.*, 137 Cal. App. 687, 31 P.(2d) 417; *Cooper v. Gibson,* 133 Cal. App. 532, 24 P.(2d) 952; *River Farms Co. v. Gibson,* 4 Cal. App. (2d) 731, 42 P. (2d) 95; *Bank of Hawaii v. Gibson,* 15 Cal. App. (2d) 407, 59 P. (2d) 559.

the exercise of the power would be futile, the situation is exactly as if the fund were not replenishable. Referring to that case the Supreme Court of California says:

> "* * * The trust status of the fund has been considered appropriate where it is theoretically replenishable by a so-called inexhaustible taxing power, but the exercise of that power is rendered fruitless by reason of economic conditions resulting in a tax-collecting incapacity." (p. 710.)

Judge Denman. Just how are you going to determine that? Take those 7 per cent bonds, just at what moment do those cease to be a different kind of obligation from the 6 per cent bonds or the 5 per cent bonds and become the same? Say I have got $100,000 worth of 7 per cent of this kind, this preferential kind. I think, if I hang onto them—I would rather take my chances on the 7 per cent and let the other fellows take their chances on the 5. Why am I not in a different class? Why aren't my interests different from the 5 per cent fellows and the 6 per cent, when it comes to assenting to something?

Mr. Downey. Your Honor, it certainly is a very difficult thing to determine whether the district is bankrupt or insolvent. I concede that. Of course, in this particular case that we are talking about, the Merced case, we have insolvency——

Judge Denman (interrupting). These questions only arise in insolvency. The question is: What was the condition at the time this new 7 per cent obligation was created? It is only after insolvency comes that we have the question arising as to preference. By the way, are there any of these specially registered bonds in this case?

Mr. Downey. Yes, I think the R. F. C. holds most of the registered bonds.

Judge Denman. I thought that was in one of the others that came up.

Mr. Downey. Your Honor, if I may make myself clear, here, counsel on the other side now are contending for a rule of State law which they say is to be recognized in bankruptcy, and they contend that under the State law the bondholder who has registered his bond has a lien or preference. Now, I argue that that is not true—I am simply speaking of the State law, itself. That is not true under the State law, under Section 52 of the Bankruptcy Act, nor under the rule of *Bates v. McHenry,* and I cite the Supreme Court of California, which says that even if there is an inexhaustible *power* of taxation, if the fund cannot be replenished as a matter of fact, then——

Judge Denman (interrupting). The point I am getting at is this: As I understand your thesis, unless a taxing area is insolvent there is a difference between the registered bond and the old bond unregistered. If it is not insolvent you have the inexhaustible taxing power, but if it is insolvent, it hasn't got the inexhaustible power, because it is exhausted, or becomes exhausted in the process of using it. I say, when is the incidence of that characteristic fixed? If at the moment when the bond is registered you have not insolvency, does not its character remain the same even though it becomes insolvent subsequently?

Mr. Downey. My answer is no, your Honor.

Judge Denman. In other words, it is a bond with a preference at one moment, but something that happens in

the future changes it into a bond that has not a preference?

Mr. Downey. Yes. Only it is not a true preference. Section 52 contemplates the method of payment in a solvent district, and if at the time of payment the district is insolvent, Section 52 has no application and the registrations which have been made theretofore under that section are out. The registration which is supposed to give 7% interest has no effect if the district becomes bankrupt. Section 52 goes out of the window as soon as bankruptcy intervenes—both as to preference of payment and 7% interest. The theory of allowing 7% on the registered bonds is that the district can pay out in full and all of the provisions of Section 52 contemplate solvency.

Now, I want to say this: This precise question is up in the State Third District Court of Appeal right now, and we argued it there about two weeks ago (*Clough v. Baber,* Civil No. 6309). We contended there we were entitle to a clear enunciation of the rule from the courts of this State. I don't know when we will have a decision, but this precise point was argued. It is the only point involved.

Judge Denman. Well, we are a subordinate court to them on that point.

Mr. Downey. All of us don't agree on that. Some of the counsel with me think other questions may be involved which they wish to discuss.

In concluding this particular branch of the case I call your Honor's attention to the four cases that were decided a year ago last November, the *Provident* case and others

that counsel for appellants so firmly rely on.[9] They particularly rely on *Provident Land Corp. v. Zumwalt* in which the irrigation district had what it claimed were surplus funds—but which the Supreme Court said were not surplus funds—and the district went out and bought bonds, and the proceeding was to set aside that sale. The Supreme Court said that created a preference in favor of the junior bondholders against those who had their bonds registered. It set aside the preference which had by the action of the district favored the junior bondholders. In the *El Camino District* case, decided at the same time, the Supreme Court held the bondholders who had a judgment against the district couldn't get execution. Why not? Among other things, because it would give them preference. It would allow them preference in the property of the district as against other bondholders who followed *Bates v. McHenry* and registered the bonds. The Supreme Court held the property of the district was exempt from execution and at the same time it held in *Clough v. Compton-Delevan Irr. Dist.*, 12 Cal. (2d) 385, that the bondholder was not entitled to partition the lands.

In the *Provident* case the district was probably insolvent, but the case did not come up on that question or on a question of bankruptcy; it simply came up on the question of whether the bondholder who got a preference by selling his bonds to the district was entitled to maintain that preference as against the registered bondholder who had been frozen out—a very different proposition from what we have here.

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9. *Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, 85 P. (2d) 116; *Moody v. Provident Irr. Dist.*, 12 Cal. (2d) 389, 85 P. (2d) 128; *El Camino Irr. Dist. v. El Camino Land Corp.*, 12 Cal. (2d) 378, 85 P. (2d) 123; *Clough v. Compton-Delevan Irr. Dist.*, 12 Cal. (2d) 385, 85 P. (2d) 126.

I hazard the assertion in closing this point, your Honors, that in every case in which *Bates v. McHenry* has been cited, and in every case in which Section 52 has been cited, the Court has held in effect that it will not permit a preference as between bondholders, and yet those cases and that section are being used here as authority for the proposition that the registered bondholder gets a preference in bankruptcy; and the cases clearly do not establish any such thing.

Judge Denman. We will recess until two o'clock.

(A recess was thereupon taken until two o'clock p. m.)

Afternoon Session.

Argument of Stephen W. Downey (continued).

Mr. Downey. Your Honors, in concluding my argument on *Bates v. McHenry,* I omitted reference to the case of *District Bond Company v. Cannon,* 20 Cal. App. (2d) 659, 67 P. (2d) 1090, which is the "Spotted Calf" case in the State courts; and leaving that out is like attempting to play Hamlet and leaving out Hamlet. That case arose under the Acquisition and Improvement Act of 1925 and that is the only statute of the State of California in which it has been finally held that there is an absolute unrestricted, inexhaustible power of taxation by the United States Supreme Court.[10] In that case, the question

10. *American Securities Company v. Forward,* 220 Cal. 566, 32 P. (2d) 343, affirmed Supreme Court of the United States under the title *Irones v. American Securities Co.,* 294 U. S. 692, 55 S. Ct. 403, 79 L. ed. 1232.

was whether, since there was an inexhaustible power of taxation behind the district, the money should be paid in the order in which the bonds were presented, as in *Bates v. McHenry* even though the district was insolvent in fact. The District Court of Appeal held that if as a matter of fact the capacity to collect the tax was gone the funds should be prorated, relying on the *Port of Astoria* case, from Oregon, and the *Kerr Glass Manufacturing Co.* case, from our own Supreme Court. The case went to the Supreme Court on a petition for rehearing, and the petition was denied, so we feel that on the State law we have a clear holding that if the power of taxation, although unlimited, theoretically, has been lost through the inability to collect, then all stand on a parity. I didn't stress that particularly in my brief, and therefore I do so now.

May it please the court, the other points will be discussed by counsel for the other districts; I think we are all interested in them. I might say, I would like to have my argument written up, and I would like to fill in my citations and references and cases and check the quotations and file it as a part of the record in this case.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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WEST COAST LIFE INSURANCE COMPANY (a corporation), PACIFIC NATIONAL BANK OF SAN FRANCISCO (a national banking association), et al.,

Appellants,

vs.

MERCED IRRIGATION DISTRICT,

Appellee.

MEMORANDUM ON GENERAL FINDING OF FAIRNESS and OUTLINE OF CLOSING ARGUMENT OF EVAN HAYNES, ON BEHALF OF APPELLANTS.

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Merced Irrigation District,

Appellee.

MEMORANDUM ON GENERAL FINDING OF FAIRNESS

and

OUTLINE OF CLOSING ARGUMENT OF EVAN HAYNES, ON BEHALF OF APPELLANTS.

INTRODUCTION.

For the sake of brevity and clearness, repetitious matter is omitted from the oral argument, confused statements are clarified, and questions from the Bench are omitted wherever the answer is self-explanatory.

Following the oral argument appears a memorandum concerning general findings, which the Court requested us to file.

If the Court please, appellants are not here demanding their pound of flesh on points of law. We believe

our points of law are good; but that is not why we are here. We believe the record demonstrates the soundness of our view that this plan—and I choose my words—is an outrage; and for that reason it is necessary that I discuss the facts at some length.

The amount the district can reasonably pay should be determined on the basis of its average income, not the lowest fluctuations thereof.

On the pyramiding point, much has been made by Mr. Downey, and other counsel in the various cases, of the proposition that the district is required to levy one-thirtieth, let us say, or one-fortieth, of the total bond issue every year, plus interest, plus the amount of the district's past defaults, and that when you get a bad year or two, or three, the result is an impossible situation.

In fact there is no such hazard, for this reason: It is true that under the California law a sufficient levy must be made each year to pay the amount coming due that year plus any amount in default; and thus the amount pyramids if defaults accumulate.

This, however, is not necessary. Thus, the first refunding plan avoided this difficulty. This district's income does fluctuate widely, because of fluctuation in power revenue, and also in farm prices. But a fluctuating income does not mean an inadequate income, and I submit as a proposition of law that if the district's income, over a reasonable period for a bond issue to mature, is sufficient to pay a certain amount, the fact that in some years its income will be low and in others high, is irrelevant. It is a common thing nowadays, as the first refunding plan proposed, in the case of debtors with widely fluctuating incomes, for bonds to be issued with maturity at the end of the total term, contemplating that the

debtor will levy high assessments when prosperous and low assessments when income is low; taking up bonds (which are callable) when they have the money, and not being bound to levy large assessments when they haven't got the money.

The first refunding plan was approved by the California District Securities Commission as legal and proper, and provided for such bonds.

It is simply a fact, therefore, that this district can, without any difficulty, devise a plan which will give the bondholders the benefit of prosperous years and will not put the district in distress in bad years.

The question of law is presented therefore, whether a plan is fair which ignores the possibility of giving the bondholders the benefit of the average of fluctuating income.

Secondly, I submit that it is the duty of the State, to do just that. This Bankruptcy Statute is a curious thing. It is, as the Court has pointed out, something in the nature of a treaty. The Supreme Court, in the *Bekins* case, says the states can contract with the United States for the surrender of some of their sovereign powers. This statute, as the Court speaks of it, is a "co-operative" venture. The Court uses that word three times in its opinion. It says Congress must not, and does not purport to, interfere with the exercise of sovereign powers.

Now, if that is true, I submit that the State's part of this co-operative venture is to provide machinery for compliance with the rules laid down in the law and the cases as to what is a fair plan. The State, I submit, is not entitled to come into Court and say, "We want a plan approved, scaling down these debts 50 per cent and also (as against the objecting bondholders) cancellation of six years of interest", unless such a plan is fair within the meaning of that word in the statute.

The district argues that the bondholders cannot be paid what the land will reasonably yield, because if a two or three, or four year period comes along when crops are bad and the landowners haven't much money, the statute compels the district to go right ahead levying the annual bond service, interest and amortization, plus all amounts in default.

We have already shown that means for avoiding this difficulty are available under the existing State law. We now submit that even if this were not true, it is incumbent on the States to provide procedural means whereby the federal requirement of fairness can be complied with.

As already shown, there would be no difficulty in having the district devise a plan, under the present statute, whereby the bondholders could be given what I submit they are entitled to, the benefit of what the lands are reasonably able to pay on the average.

Now, there are a few points, which Mr. Downey made, that I must touch upon. He seemed to say this was our plan, the bondholders' plan. That is not true. The bondholders had nothing to do with the negotiations with the RFC. In a letter submitting this plan to the bondholders, the bondholders' committee said:

> While the committee feels that the figure offered pursuant to the Reconstruction Finance Corporation loan is unduly low, it is, however, important that the committee be advised of the wishes of the bondholders'' (R. 498).

The committee stated that it would depend on their individual conditions whether they could stand to wait or not (R. 498).

Counsel made a great deal of a long letter, reading from it for fifteen minutes, from the bondholders' committee to the bondholders, submitting the first refunding plan. That letter, I assume, is not put forward as evi-

dence of the facts recited by the bondholders' committee, except, possibly, as an admission by some few of these objectors who were members of the committee that signed the letter. In any event, the opinion expressed in the letter is that in view of the Benedict Report **the district can pay the full principal amount of its debt,** provided it is given time within which to catch up on the depression.

Mr. Downey disputes our statement that this district's bonds were quoted at 56 eight months before the RFC loan. In fact, however, they were. On February 5, 1935, a bond house in San Francisco bid on Merced Union High School District bonds due July 1, 1936, at a price to yield 1.10%, and also bid 56 flat for Merced Irrigation District bonds (R. 889).

Power revenue.

As to power revenue, Mr. Downey seemed to imply that the experience of the operation of the district since 1926 shows that one does not get the revenue from the run-off that one would expect to get.

The fact is that the studies, which are quoted and cited in our briefs at length, took account very carefully of the actual experience of the district as a basis for the computations of what the power revenue would have been in the many years before the building of the dam, for which the run-off is known. They take the run-off month by month, and show what the revenue would have been on the basis of what it has been during the years of actual operation; and there is no margin of error involved. No attempt was made by appellee to upset those computations. A mere reading of them—they are both by eminent authorities from two independent sources—is a demonstration of that.

Mr. Downey is really asking the Court to say that, since, during the period of operation since 1926, which included the nine lowest consecutive years in history (R. 535), the

revenue has been less than it would have been in the experience of the run-off which is available from the records, therefore, we should take this very dry period as the average run-off. On that theory the Pacific Gas & Electric Company would only be entitled to a return on about half of the value of its power plants.

Now, let us take their estimate—not because it is defensible, but because the results are astonishing, even though we do take it. It is significant that this district's plan, which says they can pay $8,500,000, had at the time of trial become a plan to pay $7,000,000, not $8,500,000. This because in the interim (i.e., in the three years between the submission of the plan and this proceeding), they have accumulated over $1,500,000; and the total debt which they will have, if the plan is approved, will be the amount of the debt less the cash on hand.

On its own estimate of power revenue, based on these seven years, the district will receive, from the operation of the power plant, over and above operating expense and depreciation, $400,618 a year, an amount greater than that necessary to amortize the actual bond issue which they propose. The amount that it will take to amortize that debt of $7,000,000 in thirty years is $9895 **less than** the net return from the sale of power alone, i.e., after deduction of the total cost of operation, and depreciation; so that what this district says is, that this plan is fair, notwithstanding the fact that in thirty years, it will be able to pay the entire amount which it offers out of this power plant that was built for it with the bondholders' money; and during that thirty years will have $9900 odd left over to use toward general operating expenses. At the end of that thirty years, having accumulated a depreciation fund, it will, in effect, have a new power plant.

Under our computation of power revenue, which is dealt with adequately in the briefs, the surplus of the power revenue, after deduction of operating expenses and depre-

ciation, and after meeting payments on the proposed bonds, will average $64,956 a year. So, if the plan is adopted, this district will continue to operate for the next thirty years **without any expense whatsoever toward payment of its debts**, and, far from having such expenses will, taking their theory and our theory, have somewhere between $9000 and $64,000 **net income** after paying the installments on its debts, to apply toward general operating expenses of the irrigation system.

And, as I say, after thirty years they will operate the district **without any assessments at all** on our theory of operating expenses, and on their own theory there will be $100,000 a year to collect from the land, or an average of about 60 cents per acre per year that the water will cost the landowners thereafter.

Ability to pay.

Now, as to the ability of the lands to pay, the district relies almost entirely on the Benedict Report. There are two principal things to be said about that report. It dealt, for the period 1926-1928, only with a few large ranches. For the period from 1929 to 1931 it dealt with 150 out of the 2200 ranches in the district, selected by lot. It ends with the year 1931, i.e., in the depths of the depression, seven years before this action was commenced. It therefore sheds very little light on ability to pay now.

Moreover, the Benedict report repeatedly says what is obvious on the face of it, that the district was then in its early stages of development. The report starts with the year that they started to fill up the reservoir. It says repeatedly that the district was in its development stages. There are very few conclusions in it, I might say, but here is one of them:

> "Some question may be raised as"—and this is speaking as of 1931—"some question may be raised as to whether the district ever has reached a stage of earning ability such as it could meet out of production

income all its forms of cost and carry its bonded indebtedness'' (Ex. 35, pp. 19-20).

Later on, the report concedes that when the depression arrived the district had not readjusted itself to the changed condition arising from the construction of the irrigation dam system, which was obvious (Ex. 35, p. 70).

That is all the evidence Mr. Downey mentioned in support of his argument concerning ability to pay.

The most striking fact concerning the Benedict Report is that it was the basis upon which the conclusion was reached by the district and the bondholders that the first refunding plan was feasible, namely, the plan whereby the district asked that it be allowed simply to reduce interest for seven years. That is the conclusion that the district and the bondholders' committee drew from the report. Its other defects are rather hard to state orally, and I will not state them. They are detailed in our briefs.

However, let me say this, that Mr. Downey made much of the proposition that 80,000 acres of the lands in the district are in ''Class III'', as classified in this report. In fact, Class III lands are described in the report as follows: Poor irrigated farming **for crops other than rice and grain** or forage for pasture; fair to good rice and grain land; pasture from fair to excellent; dry farming grain land on areas too undulating for practical irrigation; large acreage dairy farms, where, perhaps, 25 per cent of the land will raise alfalfa, the balance to be used for natural pasture (Ex. 37, p. 130).

There is no attempt to segregate and give the amounts of each of these varieties of land, so that all we know is that these 80,000 acres contain somewhere between one and 99 per cent of fair to good rice land, and good alfalfa land; the report doesn't say how much.

Judicially, therefore, not to say practically, the report does not contain any evidence that any substantial part

of the lands in the district are not good lands. There is adequate evidence that for the most part they are good lands.

I should say something of one other item of evidence, namely, certain reports of the District Securities Commission. The appellee does not rely on it much, apparently, because it is mentioned only in a footnote in their brief; and Mr. Downey didn't mention it in his argument at all; but if the Court should read it after reading the footnote, it appears to have some plausibility, and I must mention it.

These are reports by the District Securities Commission, the Commission which, under Section 11 of the District Securities Commission Act, approves the levy by the district of low assessments in emergency periods. The section is set out in the appendix to our brief. It requires that so long as a district is levying low assessments under Section 11, it must annually make an estimate as to how much the lands can reasonably pay in assessments during the coming year; and requires that estimate to be approved by the Commission.

These reports show on their face that they were made on data supplied by the district, and that they are merely estimates of production for the coming year. Two of the reports are in the record, one for 1933 and one for 1936. The one for 1933 puts its estimate of production on the basis of the Cone report, which, in turn, is an estimate based on data supplied by employees of the district. Prices are estimated, and the report says this is a "hazardous occupation". (R. 687). Costs of production are estimated on the basis of the Benedict report, and those estimates are analyzed in great length in our brief, and shown to be undependable.

Moreover, these reports did not pretend to be for typical years in any sense. Indeed the 1936 report states that

three very important crops in the district, namely, raisins, peaches and figs, respectively were expected to be only 40, 60 and 75 per cent of normal. On the basis of that kind of data the commission accepted the district's estimate that in the coming year the income would not be sufficient to pay more than $3 per $100, with a 15 per cent delinquency. In the last two years, the delinquency was about half of 15 per cent, on the basis of their levy approved by the report (R. 668).

The yields set out as probable for the different crops in that report are, if I may say so, fantastic. Just as an example, for almonds it says the average production is 200 pounds per acre. Maybe it was that year, but the Benedict report itself shows an average crop of almonds as 800 pounds per acre, namely, 400% of the estimate in the report; and so on for deciduous fruits, raisins, alfalfa, and for other crops. (See R. 100-102, Ex. OO, p. 145).

Actually these reports amount to this: The district says, "We need $3 per $100, to operate next year. We submit the following figures as showing that is all the lands will be able to pay from earnings".

And the District Securities Commission says, "That is all right".

I have already discussed, and I will not repeat it, the testimony of Mr. Momberg, the petitioner's witness. He testified to data showing that the lands owned by the Bank of America earned about $2.50 an acre right through the depression and over a seven year period, after paying current taxes of all kinds, and actual operating expenses.[1]

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1. We set out the following table to substantiate our assertion.

Mr. Momberg, who manages these fifty ranches for California Lands, Inc. (containing a total of 3,688 acres, R. 472), testified concerning their operation from 1933 to 1937. It is true that his first testimony on direct examination was to the effect that the

Actual experience shows ability to pay.

Now, on the other hand, is there any affirmative evidence of ability to pay?

The record contains the assessments actually paid to the district year by year, since its organization, to date. These figures show that during the entire eighteen years that it has operated, including the early formative years, some very good years that followed, and the long and hard years of the depression, **the landowners have actually paid in assessments an average of $700,421 a year**

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ranches lost money on the whole. On cross-examination, however, it developed that this was not the fact.

He divided the fifty ranches into three groups of 12, 4 and 34 ranches, respectively, as appears in the table.

All of the figures in the table are the corrected figures finally testified to by Mr. Momberg, and appear in the Record at pages 481-484.

All Figures in the Table Are From R. 481-4.		12 Ranches, 572 Acres	4 Ranches, 867 Acres	34 Ranches, 2249 Acres	Total Net Profit
1933	Gross Income	$7,596	$18,368	$11,317	
	Expenses	734	13,911	888	
	Taxes	2,874	3,501	7,375	
	Net Profit	3,988	955	3,053	$7,996
1934	Gross Income	6,266	36,173	12,346	
	Expenses	3,045	22,413	1,912	
	Taxes	1,576	2,020	7,660	
	Net Profit	1,644	11,640	2,772	16,056
1935	Gross Income	6,661	25,270	11,387	
	Expenses	1,943	24,229	2,060	
	Taxes	2,002	3,460	20,350	
	Net Profit	2,715*	—2,419*	—11,022*	—10,726*
1936	Gross Income	13,435	22,470	14,602	
	Expenses	4,228	21,567	2,069	
	Taxes	2,329	3,011	8,949	
	Net Profit	6,877	—2,108	3,583	8,352
1937	Gross Income	13,775	33,958	17,753	
	Expenses	3,699	18,762	2,781	
	Taxes	2,285	2,976	7,437	
	Net Income	7,790	12,220	5,534	25,544
				Total Net Profit	$47,222

*The apparent loss for the year 1935 was in fact a net profit of $1,100, or more, instead of a net loss of $10,726. In that year California Lands,

(R. 705, 667). **This equals full payment of assessments of $6.60 per $100 on present assessed value.**

Now, that is not an estimate, it is a fact. Much of it was paid after it became due, but it was paid. That is to say, the actual experience of this district throughout the 18 years of its history has been that the landowners are willing to pay to the treasurer of the district on the average enough to amortize at 4% in thirty-three years over $15,400,000, i.e., over $8,400,000 more than the bond issue here proposed. (All such figures are based on ordinary bond amortization tables, showing what payments will amortize a given amount at a given rate of interest in a given number of years.)

The plan here proposed is a 4% refunding bond issue to be retired in 1975, i.e., in 35 years from the present.

Inc., paid up, in a lump sum, taxes levied in 1932 which had been allowed to go delinquent (R. 488). The district had been earlier threatened with a tax strike, by mortgagees and others (Ex. 00, p. 64, R. 420), and, although California Lands, Inc., apparently did not join in the threats, it apparently did join in the strike.

From the foregoing table, the following results appear:

(1) For the five-year period concerning which Mr. Momberg testified, the net income from the lands operated by him averaged (after payment of actual operating expenses and all taxes) more than $2.50 per acre per year. This notwithstanding that a considerable part of the period was in the period of very low agricultural prices. See the price table (R. 734). Agricultural prices started rising in 1933 from the all-time low of 1932, and have risen steadily ever since.

(2) The taxes over this period averaged over $3.50 per acre per year.

(3) For the years 1936 and 1937 (the only two years in which the taxes paid were the current taxes and no others (R. 486), the average net income per acre per year for the lands operated by Mr. Momberg was $4.59 per acre. Farming operations by agencies such as California Lands, Inc. are admittedly inefficient (Benedict Report, Ex. 35, p. 64).

California Lands, Inc. has in recent years sold 67 ranches (other than those dealt with in Mr. Momberg's testimony and in the foregoing table), most of the sales having taken place since 1935 (R. 489).

The foregoing figures are based on average gross power revenue of $500,000 per year, and operating expenses of $400,000 per year. The district contends that its gross power revenue will average only $445,000 and that its operating expenses are $500,000 per year.

Power revenue.

It cannot reasonably be contended that the district's revenue from power will average less than $500,000 per year.

1. Two careful studies by recognized authorities (R. 890-948, 524-38) were made. One shows that the run-off of the Merced River from 1902 to 1938, both inclusive, gives an average revenue under the district's present power sale contract (which runs until 1964), of $511,651 per year (R. 937). The other study, which carried the computation back to 1871 shows average revenue of $534,000 per year (R. 534).

2. The district itself reported to the RFC that its future power revenue would average between $500,000 and $621,000 per year (Ex. OO, p. 104).

3. A competent firm of engineers employed by the district itself gave $500,000 per year as a conservative average (Ex. OO, p. 105).

4. Figures undoubtedly supplied by the district itself to the District Securities Commission, estimated in 1936 that the power revenue for 1937 would be $500,000 (R. 728); and estimated in 1937 that the power revenue for 1938 would be $500,000 (R. 783). The amounts actually received were more than $500,000 (R. 937).

The only evidence the other way consists of the fact that during the period 1926-38, which includes the lowest consecutive nine years of run-off since 1871 (1926-34, R. 937, 535), the average power revenue was $445,000.

It is plain, we submit, that in determining probable ability to pay, the district's power revenue cannot fairly be taken as less than an average of $500,000 per year.

Operating expenses.

The only testimony concerning operating expenses is that of the secretary of the district, who testified in the former bankruptcy proceeding that operating expenses would amount to a total of $400,000, excluding payments on certain drainage bonds now fully paid, and payments on Crocker-Huffman contracts which will be fully paid next year (Ex. OO, p. 63; R. 694-5). In this proceeding he raised this to $500,000, explaining the difference by additional cost of proposed capital improvements of $30,000 per year, and some increase in labor costs (R. 515). Apparently this figure includes drainage bond payments and Crocker-Huffman payments, amounting to about $50,000 per year (R. 874, 883), which will cease entirely next year (R. 694-5).

This testimony is not directly contradicted, for appellants have no means of doing so; but it is contradicted by the undeniable fact that the district's actual operating expenses averaged only $401,134.43 for the last three years shown in the record (our Reply Br., p. 43), notwithstanding the fact that during these years the district had a large surplus of cash on hand, and had no reason, therefore, to defer proper expenditures.

Moreover, the secretary's estimate of operating expenses includes $125,000 per year for capital improvements, which we submit cannot be considered in determining the ability of the district to pay its debts.

The district's own estimated operating expenses for 1938, reported to the RFC, were less than $425,000 after eliminating payments on drainage district bonds which the district took over and which are now all paid, payments on Crocker-Huffman contracts which will all be

paid off next year, and refinancing expenses (R. 774, 783, 694-5).

Even if we take operating expenses as amounting to the district's indefensible figure of $500,000 per year, the total average revenue from assessments during the entire 18 years of the district's existence, plus average power revenue of $500,000, would pay off over $13,000,000 in 33 years at 4%, i.e., $6,000,000 more than the district proposes to pay in 35 years at 4%.

And even if we go further and accept the district's contentions concerning power, and assume that in fact gross power revenue in the future will be no more than it has been during the dry period of actual operation, i.e., since 1926 ($445,000; R. 407), and that operating expenses will in fact be $500,000 per year, even so, the average assessments actually paid in the 18 years of the district's existence, plus power revenue, less operating expenses, will give a net income sufficient to pay off a debt of over $11,800,000 in 33 years at 4%, i.e., $4,800,000 more than the plan proposes.

If we take the last seven years given in the record (1931-37), starting with, and including the whole of, the great depression, we find that the landowners actually paid in assessments during those seven years an average of $517,850 per year (R. 829, 837, 846, 853, 863, 873, 881).

Taking operating expenses as $400,000 per year, this amount of assessments, plus average power revenue of $500,000 per year, will pay off over $12,100,000 at 4% in 33 years, i.e., over $5,100,000 more than the plan proposes to pay.

Even taking the district's claim as to operating expenses of $500,000 per year, the result for these seven years would pay off $10,300,000 in 33 years at 4%, i.e., $3,300,000 more than they offer, the difference to the objecting bondholders being over $300,000.

And these seven years were far below normal in farm income. Farm prices during this seven-year period (although they have increased steadily every year since 1931 (R. 734)), were so unprecedentedly low in 1931, 1932 and 1933 as to make the average for the seven years only 86% of the period 1909-14, taken by the federal authorities as normal (R. 733-4).

Moreover, the district has not even pretended to levy anything for bond service during 5½ of those seven years, the rate being from $3.00 per $100 down to $1.00 per $100 of assessed value (R. 667); so that in spite of itself, the district's income from assessments and normal power revenue has, during this period, far exceeded what its plan proposes as fair.

Our brief contains a detailed statement of the district's experience in the last three years (showing actual income sufficient to pay many millions more than it offers), and I shall not take time to restate it now (Reply Br., pp. 41-47).

In the year 1932, when agricultural prices fell to their lowest point (44% of the 1909-14 average, R. 734), and when the district levied the highest rate in its history, resulting in a 62% delinquency, the landowners actually paid in assessments $578,110.38 (R. 837); enough, with normal power revenue of $500,000 and expenses of $400,000, to amortize over $13,000,000 in 33 years at 4%. Or taking operating expenses as $500,000 per year, enough to amortize over $11,400,000 on the same terms, i.e., $4,400,000 more than the plan proposes to amortize in 35 years at 4%.

The simple fact is, therefore, that it appears indisputably from the records of the district, that the landowners have demonstrated, by actually paying them, both ability and willingness to pay assessments sufficient, with the district's other income, to amortize a refunding bond

issue many millions greater than that here sought to be approved.

And this is true, as a matter of physical fact, (a) taking the entire history of the district, i.e., the entire 18 years of its existence; (b) taking the last seven years; (c) taking the last three years; and (d) taking the worst agricultural year in the last forty years, namely, 1932.

There is, to be sure, some evidence (dealing with the early years of the district) that at that time some undetermined amount of assessments was being paid with outside funds, i.e., with income not derived from operations in the district. Two comments are appropriate: (1) There is no evidence that this is true in any substantial degree in recent years; (2) we submit that it is irrelevant in any event for the following reason:

Its only relevance is, of course, on the question of the extent of the ability of the debtor to pay. But the debtor is the district. Its income, as already shown at length and in our briefs, is such that it is able to pay many millions more than it offers to pay. We submit that the ultimate source of some part of its income from assessments is irrelevant.

Moreover, the debt in question is in substance a capital debt; it is the purchase price for the hydro-electric plant and irrigation system of the district. This property, in legal effect, belongs to the landowners (see authorities in our Reply Brief, pp. 28-29), and, indeed, it is obvious that the existence of these improvements is a principal cause of the value of the lands in the district. These improvements were paid for with the bondholders' money, i.e., are the source of the debt here in question. We know of no rule of law, whether in bankruptcy or elsewhere, by virtue of which a debtor can say that he need not pay for property purchased unless he can pay for it out of the income which he receives therefrom.

It is proper to point out that disapproval of the plan here proposed would not mean that the district would then be helplessly confronted with the full amount of its debts. In the first place, as we believe is shown, those debts have been scaled down over $9,500,000 already, by the contract with the RFC. (See particularly the Brief for Appellants Florence Moore, et al, p. 20, et seq.) In the second place, it is, of course, simply not true that in determining whether a plan proposed by a debtor is fair, the Court should consider that there are only two alternatives, namely, either the plan proposed or nothing. On the contrary, the Court may suggest, or the litigant may later propose, a different plan. Obviously if it were true that the only alternatives were either the particular plan proposed or nothing, then every plan would have to be held fair, however unfair in fact, if it was found that the debtor could not pay its debts in full without undue distress. All this is made plain in Case v. Los Angeles Lumber Products Co., 308 U. S. 106.

In other words, the question here is not whether the debtor can pay its debts in full, but whether the offer to pay fifty-one cents on the dollar, with no interest whatever (as to any bondholders who object) after July 1, 1931, is a fair offer.

The market value of the privately owned lands in the district far exceeds the amount offered by the plan.

The question of the value of the lands in the district has already been discussed at some length. Briefly, the assessment roll of the district values the privately-owned lands, as of 1937-38, at $11,468,155 (R. 667). In 1930-31 the district's assessment rolls valued the lands at over $20,000,000 (R. 667). This was reduced over $1,000,000 in 1931-32 and was further reduced over $6,000,000 in 1932-33, for reasons that do not appear other than the commence-

ment of negotiations for scaling down the district's debts (R. 667). In this connection it is significant that improvements on the lands are not assessed at all (R. 425), although, of course, those improvements go with the lands in the event the lands are taken over for nonpayment of assessments. Improvements are ignored in assessment simply in order to apportion a fair share of the taxes to land allowed to lie idle.

In 1936-37 the county assessed the lands of the district at $21,829,003 (R. 719). In connection with its application to the RFC for the loan here involved, the district informed the RFC that the valuation of lands in the county's assessment (for 1933-34) average $30 per acre, and that that amount was about 30% of the market value of the lands (Ex. OO, p. 103). This stated in effect that the rural lands alone had a market value in excess of $17,000,000. Prices of agricultural products increased from 1934 to 1937 over 75% (R. 734).

The petitioner's witness Momberg testified that he was the manager of 58 ranches in the district containing a total of 3688 acres owned by California Lands, Inc.; that these ranches were scattered all over the district; that they raised substantially all the crops grown in the valley; that the quality of these lands represented an average of all lands in the district; that the lands managed by him were held for sale at an average price of $135 per acre; that this sales price was determined by determining what amount the lands could pay **from earnings** so as to pay interest on the sale price, and also pay all of their taxes (R. 473, 474, 489, 492, 494).

These figures give a total market value, at the time of trial, of the agricultural lands alone, in excess of $23,000,000.

We submit on this ground alone that the plan is unfair as a matter of law under the rule of *Case v. Los Angeles Lumber Products Co.,* 308 U. S. 106. The only other

evidence of market value is an estimate in the Benedict Report, made many years ago, in the depths of the depression (Ex. 35, p. 128); and, indeed, even that report, speaking of the agricultural lands alone, totally ignoring the five cities and towns in the district, and ignoring all improvements on the agricultural lands, put a bare-land value on the agricultural lands of over $10,500,000 (Ex. 35, p. 128).

Judge Denman. Put your young men to work and get it in the brief, what you think about the statement of the statutory outcome of this finding (of fairness) under this statute.

Is RFC a secured creditor?

Mr. Haynes. Concerning the RFC, I submit that the RFC is a secured creditor, and, if it is, there is no question but what it is in a different class from the rest of us because the statute says so.

Judge Denman. Let me suggest to you this possible viewpoint on that: Of course, the only question there is as to whether or not the consent or participation of the RFC was on this loan or in that peculiar status that is granted to it by the definition in 402, isn't it? If it is in that status, this loan to the district is not one of the credits to be considered at all. That is to say, the definition consigns the claim of the RFC to the bonds it holds outstanding, of the old bonds.

Now, I understand your position to be that there is a loan, a definite loan, from the RFC to the district, which is secured by these old bonds, and also by a fund. Now to maintain your thesis, and you may be right, you have got to say that they were consenting in fact to the new loan and not the old?

Mr. Haynes. Let us see if that is necessarily so.

Judge Denman. You can go right along, but you say, as I understand you, that your theory is an allocation of

the power income, which is security for the money loaned by the RFC, and you say that makes a secured claim, and therefore, it hasn't got the same position that the others have?

Mr. Haynes. Let me just say this, your Honor——

Judge Denman. Now, what I am saying is, is it the interpretation of the definition that the only way that a governmental agency lending money is a principal, is through these outstanding bonds?

Mr. Haynes. I believe the answer is this, if the Court please: The RFC cannot consent at all under the statute unless it is a creditor; and it can consent only in its character as a creditor. Its consent filed in the case, if it has any significance, is as a creditor by virtue of the old bonds which it says it holds. If it is a creditor in any sense by virtue of its holding of those bonds, then, inescapably, under the language of its contract with the district, it is a secured creditor. The original resolution authorizing the loan, dated November 14, 1934, says:

> "(i) Allocation of Power Revenues: Unless the Borrower shall provide for the allocation of funds and income derived from the sale of electrical power by the Borrower to the payment of the loan authorized by this Resolution in an amount and manner satisfactory to the Division Chief and Counsel." (Ex. OO, pp. 177-8.)

And the final refunding bond purchase contract (Ex. OO, p. 202) provides for the same allocation of power revenue to the maintenance of a reserve fund and to the ultimate payment of the refunding bonds (Ex. OO, pp. 208-210). This reserve fund now contains over $1,000,000 (R. 669).

The debt of the district to the RFC is now evidenced, not by the contractual documents, but by the old bonds. There is no doubt that this is true. As appellee insists, the contracts provide that the old bonds may be kept alive "for any purpose". Moreover, the RFC reserves the right

in the contractual documents to require the district to levy assessments to meet the old bonds held by it, the RFC (Ex. OO, p. 165). There is no doubt from these and other provisions (e.g. p. 164, paragraph (c)) that until the old bonds are exchanged for refunding bonds, **the RFC loan is evidenced by the old bonds**; and that loan is a secured loan and therefore in a different class from the objecting bondholders.

I should say in passing that the extent of the RFC's rights in the old bonds, full exercise of which might embarrass the district, cannot be availed of by the district as a threat, either to the objecting bondholders or to the Court, as an argument that the plan should be approved. This is squarely held in Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 129-31.

Moreover, the district has the right to tender refunding bonds for the old bonds at any time.

Payment of interest to consenting bondholders and the RFC as making the plan unfair.

On the question of fairness I should like to add a word to what has been said concerning the fact that the old bondholders were paid 4% interest, to the total amount of some $168,000 (R. 368), on the amount offered by the plan, and the fact that the RFC has received 4% interest from the time of its disbursement, i.e., October 4, 1935 (R. 344), namely, a total of 16% so far. The objecting bondholders, on the other hand, have received no interest or payment of any kind since July 1, 1931; and the plan proposes that they shall not receive anything, except the principal amount offered by the plan.

As we have seen, the district has for years had ample funds with which to pay all delinquent interest to the objecting bondholders. Its refusal to do so was, under the California law as shown in our briefs, a wholly illegal act

unless the plan was already tentatively in effect. If it was tentatively in effect, then it has operated for over four years already to discriminate against and penalize the bondholders who presumed to question it.

Now, fairness, I suppose, is a question of fairness to all.

In this case the bondholders were told, "If you have the temerity to question our plan, you must forego any income on your money for such time as it takes to litigate." Moreover, the bondholders were told that "If you don't like this plan, and you wish to withdraw these bonds, it will cost you $9.18 per bond for expenses to date" (R. 587). For some reason, the district apparently later repaid that $9.18 itself, but that is what the bondholders were told when the plan was submitted to them (R. 587).

It seems to me that in an ultimate sense, the principle of unconstitutional conditions comes in here. There is a great body of law that in making contracts, the government is in a different position, because of its capacity for compulsion, from that of an ordinary citizen, who can make as hard a bargain as he likes within rather wide limits. Statutes are held void which impose unreasonable conditions upon the exercise of ordinary rights, starting with *Western Union v. Kansas,* 218 U. S. 1, and down to date. The bondholders here were confronted by an agency of the State of California and an agency of the Federal Government, which looked the bondholder in the eye and said, "Here is what we offer you. Now, what are you going to do about it?"

The penalty for questioning their proposal was loss of income for such time as it might take to litigate it, plus $9.18 per bond.

What does "parity" mean in the RFC contract?

One further point concerning the RFC, namely, its actual intent. They undoubtedly wanted to maintain "parity" with the non-consenting bondholders. The only question is, so far as intent goes, What did they mean by "parity"?

Now, this contract expressly subjects itself to the law of California. It was made long before the Ashton decision; and there is no reason that I know of to suppose that any modification of the statute was in contemplation. What did they mean when they said in effect, "We want to maintain 'parity' with the old bondholders"?

Well, there was quite a lot of law about it. In California, *Anglo-California Trust Company v. Oakland Railways,* which we cite, and in other states and in federal cases, there were many decisions on the question of what "parity" a bondholder consenting to a partially completed reorganization is entitled to. They held that he is entitled to parity; and they meant that in the distribution of any fund, the consenting bondholder may get the same share that he would have got if he had kept his old bonds, **up to the amount of the reduced debt.**

There is no reason to suppose that the RFC intended to do more than the law permitted it to do at that time, so far as anybody knew under any existing authority. The bond purchase contract does not intimate that it did. It is not a conditional loan in any sense.

Judge Mathews. Does it require that non-consenting bondholders be treated differently than the RFC?

Mr. Haynes. It does not require that they be, but it plainly contemplates that they will be, if some do not consent, as is shown by the passage now to be quoted, and others:

> "The RFC shall be under no obligation to purchase refunding bonds beyond the amount necessary in its

> judgment for refunding the indebtedness owed to creditors of the borrower who join in the plan of refinancing'' (Ex. OO, pp. 205-6).

Upon motion by the objecting bondholders, the RFC was, upon order of the Court below (R. 139), served with notice to appear at a hearing to determine whether or not it is a creditor affected by the proposed plan of composition (R. 140). The matter was continued once, the RFC not appearing on the date set (R. 141, 142), but the RFC never did appear in response to the notice (R. 145). (The provision of the statute pursuant to which this notice was given reads as follows:

> ''No creditor shall be deemed to be affected by any plan of composition unless the same shall affect his interest materially, and in case any controversy shall arise as to whether any creditor or class of creditors shall or shall not be affected, the issue shall be determined by the judge, after hearing, upon notice to the parties interested.'')

It is, we submit, significant on the question of actual desire and intent of the RFC, that it has taken no part or interest in this proceeding whatsoever, other than to supply the district with its consent to the plan.

All benefits received by the district, including the RFC contract, are held in trust for the bondholders, under California law.

If the district's debt was scaled down in substance at the time of the contract, the district, which holds all its assets in trust for the bondholders, was not at liberty to deny the benefit thereof to its remaining bondholders. A private corporation, to be sure, can buy its old bonds at any price, and re-issue them, and thus keep them alive. But the district has no such power. If this district got a benefit from the RFC, it got it in trust for the bondhold-

ers. If the district profited by some old bondholders surrendering their bonds for 50 cents on the dollar, that benefit was received in trust for the remaining bondholders.

Lack of good faith.

Now, Mr. Downey sought to depreciate our discussion of the district's lack of good faith. The statute requires the plan to be submitted to the Court in good faith. Counsel says that the matters we discuss are matters of bookkeeping. Most of them are. But it is a notorious fact that there is no better way known for misleading a reader, on the value and amount of assets and liabilities, than bookkeeping. Our briefs point out where (without any moral wrong-doing, I suppose, but in an excess of loyalty), the officers and agents of this district have submitted data to the Court which are, to say the least, very misleading as to the financial history and present condition of the district. Mr. Lucius Chase, of Los Angeles, was to argue that matter, but he is sick in bed.

Res judicata.

Concerning the question of *res judicata,* I submit that the question deserves serious consideration, and ask the Court to give it that consideration. It should be considered with some of the fundamental propositions that are well established in mind.

The first is this: Mr. Justice Mathews asked, quite naturally, Which are you going to overrule, the new case or the old case? The answer is that a question of law can be *res judicata,* as well as a question of fact. And this rule would be meaningless unless it applied in cases where the true law at the time of the second decision is different from what it was at the time of the previous decision, or is unknown. There is no need of invoking the proposition that a rule of law is settled between the parties, if the

existing law is the same. In a recent case, *Stoll v. Gottlieb,* 305 U. S. 165, the Supreme Court says in effect,

> "We don't know what the law is on this question, but in any event it is settled between these parties by the previous decision."

It said concerning the rule of law which had been adjudicated between the parties (p. 172):

> "We express no opinion as to whether the Bankruptcy Court did or did not have jurisdiction of the subject matter."

The principle that a rule of law may be *res judicata* assumes that the law is different now from what it was at the time of the earlier decision.

Judge Mathews. Or that it is now claimed to be different?

Mr. Haynes. Yes, your Honor.

Judge Mathews. Just as an issue of fact litigated in a former case is sought to be relitigated by someone who proposes to establish the contrary fact in the present one?

Mr. Haynes. I should have stated it that way, your Honor.

That leaves just one question here, namely, What was adjudicated in the previous case between these parties?

There has been a good deal of talk about the Court having no jurisdiction. Well, it had jurisdiction to decide whether it had jurisdiction, and did so. A considerable part of the law of this country is in opinions holding that the Court had or did not have jurisdiction. The *Ashton* case is an example. The Supreme Court has gone so far as to hold that a Court has jurisdiction to decide that it has jurisdiction, even though it has not, and that its decision to that effect is *res judicata,* even though wrong (*Stoll v. Gottlieb, supra*).

Now, the record in this case contains the decree of this Court granting our motion to dismiss for want of juris-

diction (R. 106). The order doesn't say what the ground of the decision was, but the most elementary rule of *res judicata* is, of course, that when you want to find out what was litigated, what matters were settled between the parties by an earlier decision, you look at the documents in the case. As the Supreme Court said in *Oklahoma v. Texas,* 256 U. S., page 70, at page 88:

> "What was involved and determined in the former suit is to be tested by an examination of the record and proceedings therein, including the pleadings, the evidence submitted, the respective contentions of the parties, and the findings and opinion of the court; there being no suggestion that this is a proper case for resorting to extrinsic evidence. Russell v. Place, 94 U. S. 606, 608, 24 L. ed. 214, 215; Last Chance Min. Co. v. Tyler Min. Co., 157 U. S. 683, 688, et seq., 39 L. ed. 859, 862, 15 Sup. Ct. Rep. 733, 18 Mor. Min. Rep. 205; Baker v. Cummings, 181 U. S. 117, 124-130, 45 L. ed. 776, 779-782, 21 Sup. Ct. Rep. 578; National Foundry & Pipe Works v. Oconto Water Supply Co., 183 U. S. 216, 234, 46 L. ed. 157, 169, 22 Sup. Ct. Rep. 111."

Now, the pleadings in the previous case between these parties consisted solely of a motion to dispense with the printing of the record and to dismiss the action for want of jurisdiction (Ex. OO, p. 333). One ground, and one only, was stated in support of that motion, namely, that the Supreme Court had, since the decision in the Court below, decided the *Ashton* case, holding that Congress is without power to enact laws on the subject of bankruptcies subjecting the bonds here involved to being scaled down compulsorily. Now, there is no question at all, obviously, that that is what this Court decided when it decided the case.

There cannot be any question about what was adjudicated in the *Ashton* case; the Court's language is too plain. The Court did not decide on any detail of the

earlier statute. It dealt with the question of power. It said:

> "Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. * * *
>
> "The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify or impair the obligation of their contracts. The statute before us expresses this design in plain terms. It undertakes to extend the supposed power of the Federal Government incident to bankruptcy over any embarrassed district which may apply to the Court. * * *
>
> "Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. *United States v. Butler,* decided January 6, 1936, 297 U. S. 1. The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation. See *United States v. Constantine,* 296 U. S. 287. * * *
>
> "'* * * for a very long time this court has steadfastly adhered to the doctrine that the taxing power of Congress does not extend to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause. *United States v. Butler, supra.*"

I submit that on no imaginable grounds could it be held that the decision in that case would have been different if the statute before it had been this statute and not that statute. The power claimed is identical in both cases, and, in fact, it is exercised in substantially the same manner.

Now, is there anything shocking about the doctrine of *res judicata?* I submit that the question does not arise, because the Supreme Court has answered it in laying down the rule. This controversy received the considera-

tion of the Supreme Court of the United States in the *Ashton* case, and again in the previous case between these parties. The Court decided that there wasn't any such crying public need for the relief here sought to make it necessary to uphold this legislation.

The Court, as presently constituted, holds otherwise; but the only ground upon which it could rationally be argued that this case should be ruled out of the doctrine of *res judicata* would be that the results are too appalling; and I submit that in view of the earlier decision of the Supreme Court, that would be difficult.

Judge Denman. The Supreme Court, in a sense, is a super-legislative body, which, when it decides a thing one time, makes the law valid as to that, and when it overrules itself and decides another way, it makes the law as to that, and that is a legislative function, and your viewpoint would be the opposite of that?

Mr. Haynes. I don't see why.

Judge Denman. After all, can't something be said for that viewpoint? The Chief Justice, during his teaching period, had some views that seemed to suggest that, but in this later decision the tribunal adjudicated something that could not have been adjudicated before, and that something is the controversy over the validity of the plant, and its value, rather than where it is going to be tried out. I am just quoting.

Mr. Haynes. I don't follow your Honor at all.

Judge Denman. Your argument does not permit that line of contemplation?

Mr. Haynes. I didn't understand, your Honor.

Judge Denman. What you have here is a statement that the opinion of the Supreme Court is that we now have a tribunal open for this class of controversy; suppose the Legislature had done the same thing?

Mr. Haynes. In so far as Courts may be said to legislate, the doctrine that rules of law become *res judicata*

says that the later enactment does not apply as between parties who have already litigated the question.

Judge Denman. I am wondering if it is *res judicata.* It was decided at a time when there was no tribunal to hear the case, and it is adjudicated now at a time there is one, even though one would be overruling the other.

Mr. Haynes. What was adjudicated in the first case was not merely whether a tribunal existed which could grant the relief here sought, but whether the Constitution of the United States granted power to Congress to create such a tribunal.

There are cases which are more striking than this one. Mr. Clark is going to refer to the case of Stone against the Farmers Bank, in 174 U. S. 409. In that case a corporation had a charter, as we have a bond, exempting it, or it contended that it did, from taxation, a contract from the state not to tax it for ordinary property taxes. Two or three local taxing bodies, cities and counties, attempted to, and the bank sought an injunction and got it, and it was affirmed in the Supreme Court of Kentucky, which held that the contract was within the scope of the impairment of contracts clause in the Federal Constitution.

The taxing people persisted. A new taxing statute was passed, and new levies were made, years later.

Now, may I pause here a moment to say that there is no question but that the levying of taxes is a legislative act, and a new levy creates a new cause of action.

Very well; a new levy was made under the new statute, and the matter was again dragged through the Courts, and this time the bank sought to enjoin some of those with whom it had litigated the matter before, and some others in addition. The Supreme Court of Kentucky said in effect, "We disagree with our previous decision and hold that this charter is within the power of the state to amend its contracts under the police power." The Supreme Court of the United States agreed with the latter case on appeal to it by the bank. It held, however, that

as to the cities and counties which were parties to the first suit this charter was within the impairment of obligations or contracts clause, and that as to those who were not parties to the previous suit, the judgment of the Supreme Court of the United States prevailed, namely, that the charter was not, and never had been, within the scope of the impairment of obligations of contracts clause.

Judge Denman. But there is no question of tribunals in which the controversies are between the parties?

It is not a case involving a jurisdictional tribunal in which the contracts are to be settled. That was whether or not there was a change in the contract.

Mr. Haynes. Yes, your Honor.

Judge Denman. But I don't regard litigation in bankruptcy as a part of the body of law which enters into the contract and which cannot be changed. I don't see the district and its bond having incorporated into it the then existing law regarding bankruptcy, or any future existing law regarding bankruptcy.

Mr. Haynes. I don't think so, either.

Judge Denman. I don't see any impairment of the obligation of contracts by saying that I cannot see the analogy between your other case, which had to do with the merits of a controversy as to whether or not there had been an impairment of the obligation of contracts, and this case, which has to do with whether or not a tribunal exists to try another kind of controversy.

Mr. Haynes. In both cases this is true, is it not, your Honor, as in countless other cases involving different kinds of rules of law: a rule of constitutional law was laid down which the Court applied in the second case.

Judge Denman. Upon the merits that was decided upon, whether or not there had been an impairment of the obligation of contracts. In the second one they said, "The merits of that controversy having been decided as a matter of law, it will prevail here." We never got to the merits in this case.

It was held that the tribunal had the power the second time. That is what I am thinking at the present moment.

Mr. Haynes. It seems to me that nothing more fundamental, more meritorious, more on the merits, could be imagined than a decision of the Supreme Court of the United States that these bondholders could invoke the protection of the sovereignty of the states against an attempted exercise by the Federal Government of the power of bankruptcy, or, stated in another way, nothing could be more fundamental than a decision as to the division of powers between State and Nation effected by the Constitution of the United States. It was an epochal decision that the bankruptcy power does not include such contracts. The doctrine of *res judicata* is, that if a rule of law is laid down in an action between the parties, which, if applied in a later suit between them controls the result, then the second action is controlled by the first. I don't believe that any amount of talk about jurisdiction or no jurisdiction can affect the proposition that the rule of law laid down in the first case between these parties was a rule of law which, applied here, concludes it, and the rule of *res judicata* says just that.

Judge Mathews. The determination of a jurisdictional question often involves a determination of fact and often involves a determination of law, or both, and your argument is that such determination is conclusive on the parties in later litigation, regardless of whether the determination was made in connection with a jurisdictional question of some other kind of a question?

Mr. Haynes. Precisely, your Honor.

Judge Mathews. Provided that that determination was a necessary thing?

Mr. Haynes. Yes, your Honor.

Judge Denman. The cases you have spoken of here involving jurisdiction were cases where jurisdiction had been held to exist and the merits have been gone into? I am speaking now of the cases you mentioned; I have

not read the citations you have given. Have you a case that is exactly like this anywhere?

Mr. Haynes. I don't recall one, your Honor. The only doubt has been just the other way around. Up until quite recently, up until the case of *Stoll v. Gottlieb* (supra), there had been a considerable amount of opinion in support of the proposition that if the Court did not have jurisdiction and decided that it did, its judgment was void. But the Supreme Court now says that is not true.

Now, there has never been any question, so far as I know, of the jurisdiction of a Court which **had** jurisdiction to decide finally, even though erroneously, that it **did not have** jurisdiction.

Let us say that the next day after the decision in the *Ashton* case, the district involved in the *Ashton* case had filed another proceeding; wouldn't your Honor's argument call for the conclusion that the Court would have to entertain the new suit, and start all over again? I cannot see any escape from that.

May I presume to say this in closing: That never in my limited experience has a Court been so indulgent, so patient, and, if I may say so, so industriously interested in the case before it.

MEMORANDUM ON GENERAL FINDINGS OF FAIRNESS.

Pursuant to the direction of the Court at the oral argument, we filed this memorandum on the question whether a general finding of fairness is a sufficient finding of fact. The trial Court's finding on this question reads as follows:

> "That the plan of composition as offered by the petitioner herein is fair, equitable and for the best interests of its creditors and does not discriminate unfairly in favor of or against any creditor or creditors or class of creditors" (R. 214).

Numerous federal statutes, of course, require findings of fact in particular actions. Such statutes are discussed in the cases cited below.

Preliminarily, it is perhaps proper to state the fundamental rules on the subject. Findings of fact must be findings of ultimate facts, not of evidentiary or probative facts:

U. S. v. Esnault-Pelterie, 299 U. S. 201, 205.

On the other hand, the findings must be findings of fact, not conclusions of law:

U. S. v. Jefferson Electric Co., 291 U. S. 386, 408;
U. S. v. Esnault-Pelterie, 299 U. S. 201, 205;
Kahn v. Smelting Co., 102 U. S. 641, 647.

Findings by the Court were unknown to the common law. Their purpose, and the rules concerning them, are similar to those concerning special verdicts:

Anglo-American Land Co. v. Lombard, 132 Fed. 721, 733, and cases cited;
U. S. v. Sioux City Stock Yards Co., 167 Fed. 123, and cases cited;
St. Louis v. The Ferry Co., 78 U. S. 423, 428.

Their purpose is to enable the appellate courts to determine whether the trial Court properly applied the law to the facts of the case; and to enable the appellate court

to order the correct judgment, if the trial Court's view of the law was erroneous:

> *Anglo-American Land Co. v. Lombard,* 132 Fed. 721, 733, and cases cited.

The question, therefore, is whether or not the trial Court's finding simply that the plan is "fair," is a proper finding of ultimate fact or a mere conclusion of law.

There is, of course, no mechanical test whereby the answer to questions like this can be easily and infallibly determined. The question must be answered on the basis of the particular considerations present, as to each particular type of proposition concerning which the question arises. This is illustrated by the following quotation from Ruling Case Law:

> "Propositions which are in reality conclusions of law cannot be given effect as findings though included with the findings of fact. * * * Accordingly a finding that a mistake occurred through neglect of legal duty by a party, or that money was paid to a party as legatee, as well as a finding that a contract is contrary to public policy, or that a contract provision is reasonable, is merely a conclusion of law. Likewise where a finding that a defense is sustained is based specifically on a finding of fact it cannot be given effect as an independent finding of fact. On the other hand a finding as to the cost of an article, or that a party did not rescind a sale, or that parties were living together, or that the plaintiff is the owner of a right of way and that it is an appurtenance to land, is a finding of fact" (26 R. C. L. 1091-1092).

In the first place, it is unnecessary to argue the proposition that the question is not to be answered on the basis of some mechanical test, but must be decided on the basis of the substantial considerations involved. We believe that there are several substantial considerations that should be taken account of:

1. The question of substantive law presented is relatively new, and yet to be finally settled by the Court of last resort.

For that reason it appears that the trial Court should find the facts bearing on the question whether the plan is fair, so as to enable the Courts on appeal to know the legal basis upon which the trial Court reached its conclusion. This proposition is supported by the case of

U. S. v. Jefferson Electric Co., 291 U. S. 386.

That case was a suit to recover back sales taxes alleged to have been illegally collected, which were recoverable only if "such amount was not collected, directly or indirectly, from the purchaser or lessee, or that such amount, although collected from the purchaser or lessee, was returned to him". On this question, the trial Court found that plaintiff had "sustained the burden of proof"; and (after reciting certain circumstances) found in terms that although "the tax was collected from the purchasers" by plaintiff, it "was wholly returned to them".

The Supreme Court said in part (p. 408):

> "Saying that the plaintiff has sustained the burden of proof as to the designated issue in suit No. 3371 is not an adequate finding of the matters of fact involved in that issue, **particularly where, as here, the subject is new and may admit of differing opinions.** It is in the nature of a legal conclusion rather than a finding of the underlying facts, and we think it does not adequately respond to the issue and is not sufficient to support the judgment which rests on it."

And further, after disagreeing with the trial Court's conclusion (quoted above), said (p. 409):

> "* * * That conclusion must therefore be disregarded. It results that the finding, while showing that the plaintiff collected the tax from the purchasers, does not show whether it returned the tax to them. Thus the finding does not adequately respond to the issue arising on the plaintiff's allegation that

it absorbed the tax—for, having collected it from them, the plaintiff could absorb it only by returning it to them. With that matter left in this situation the finding plainly does not support the judgments which rest on it.

"As the judgments of the District Court in the three suits must be reversed because of insufficiencies in the special findings, and as the reversal by the Circuit Court of Appeals was put on an untenable ground, we deem it the better course to enter here a judgment reversing the judgments of both courts and remanding the suits to the District Court with a direction to vacate its findings and grant a new trial in each suit."

2. It is obvious that the question whether a particular plan is fair, involves several questions of law, which, indeed, are presented by the facts of this case. For example,

(a) Is a plan fair which offers much less than the income of the debtor district will enable it to pay, merely because in the past some of the landowners, and doubtless some still, are unable to pay all of their assessments out of net income derived from the land?

(b) Is a plan fair under which a taxing district offers an amount much less than the market value of the lands of the district charged with payment of its debts?

(c) Can a plan be held to be fair on the basis of evidence (we say insufficient evidence), that the agricultural income of the district would not justify payment of a greater amount, where, as a matter of fact, the landowners have, year by year, throughout the entire history of the district, actually paid in assessments an amount sufficient (together with the district's other income) to pay a much greater amount than that offered? These and similar questions of law as to what is "fair" (discussed in our briefs) are yet to be settled.

This being true, it is apparent that a finding simply, in the language of the statute, that a plan is "fair", makes it impossible for the Court on appeal to determine whether or not the case was correctly decided in the Court below.

The case of

Miller v. Gusta, 103 Cal. App. 32,

together with the cases cited in the opinion therein, illustrate and emphasize this proposition. In California, by statute, specific performance of a contract cannot be granted unless the contract is, as against defendant, fair and reasonable and supported by adequate consideration. Under this statute the Courts hold that a finding, merely in the language of the statute, will not support a judgment; since to hold that such a finding is sufficient would confer on the trial Courts unlimited power to follow their individual ideas concerning the legal meaning of the requirements of fairness. Thus, in *Miller v. Gusta, supra,* the Court said:

> "While it is undoubtedly true, as suggested by counsel, that operation through a receiver is ordinarily more costly and less profitable than the same operation would otherwise be, these figures are none the less startling. Even in the face of them, however, we would feel compelled to accept the finding of the trial court upon this conflicting evidence if that finding was sufficient. But, as suggested above, the finding is subject to the same vice as the pleading in that it follows the identical language of the complaint above set out. **In other words, the trial court instead of finding the facts from which the justness and reasonableness of the contract and the adequacy of the consideration would follow as a conclusion of law simply found 'that said contract is fair and equitable and that the consideration * * * is an adequate consideration.'** Under the authorities above quoted this is a **bald conclusion of law. It is impossible from this finding for this court to know on appeal what value the court put on any of the properties involved in the exchange. Nor can we even conjecture in view**

> **of the sharp conflict in the testimony what values the trial court may have had in mind, or what sort of contract in the trial judge's opinion would be fair and equitable or what consideration adequate. The values might, if they had been found by the trial court, be so disproportionate as to lead this court to disagree with the trial court's conclusion as to the fairness of the contract and the adequacy of the consideration. As to that we are left in the dark."**

So here, we submit, unless the trial Courts find the ultimate facts upon which they base the conclusion that a particular plan is fair or not fair, then the function of the appellate courts will be wholly frustrated, since they will be powerless to require the trial Courts to conform to the relevant rules of law concerning what is fair.

3. The opinion of the Supreme Court in

Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 113-114, 119,

seems to leave no doubt that the question of fairness is a question of law to be determined from ultimate facts. In that case, indeed, the trial Court had found the plan fair; but the Supreme Court found no difficulty in reversing the decision on the ground that the plan was not fair.

If "fairness" is an ultimate fact, then the trial court may, and should, refuse to find the facts upon which its finding of fairness rests. If so, the reversal in the *Los Angeles Lumber Products* case was due to the purely accidental circumstance that the facts bearing on fairness appeared incidentally in the record.

Other cases decided under Section 77B point in the same direction. See

Tennessee Publishing Co. v. American Nat. Bank, 299 U. S. 18;

Central States Life Ins. Co. v. Koplar Co., 85 F(2d) 181;

Wayne United Gas Co. v. Owens-Illinois Glass Co., 91 F(2d) 827.

It is, we submit, clear that the finding of good faith (R. 214), is in the same category. See

John Hancock Mut. Life Ins. Co. v. Bartels, 84 L. Ed. (Adv. Ops.) 154.

4. The statute here involved requires (a) that the Court be satisfied that the plan is fair, and (b) that it make findings of fact. The latter provision is meaningless if the only finding of fact that need be made on the question of fairness is a bald statement that the plan is fair.

For the foregoing reasons and for the further reasons stated in our briefs, we submit that the question whether or not this plan is fair is at large; that the trial Court's finding upon the question is a mere conclusion of law. See particularly our Reply Brief, pages 33-34.

Respectfully submitted,

Chas. L. Childers,
Hugh K. McKevitt,
Clark, Nichols & Eltse,
George Clark,
Chase, Barnes & Chase,
Lucius F. Chase,
Peter tum Suden,
David Freidenrich,
Herman Phleger,
Brobeck, Phleger & Harrison,
W. Coburn Cook,
By Evan Haynes,
Attorneys for Appellants.

Dated, San Francisco, California,
February 19, 1940.

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

WEST COAST LIFE INSURANCE COMPANY (a corporation), PACIFIC NATIONAL BANK OF SAN FRANCISCO (a national banking association), et al.,

Appellants,

vs.

MERCED IRRIGATION DISTRICT,

Appellee.

(And 3 Companion Cases)

REFERENCE AND ANSWER TO CITATION BY APPELLEES OF PEOPLES STATE BANK v. IMPERIAL IRRIGATION DISTRICT.

(Filed by Appellants Pursuant to Permission of the Court.)

BROBECK, PHLEGER & HARRISON,
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San Francisco, California,

DAVID FREIDENRICH,
Stock Exchange Building,
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HUGH K. MCKEVITT,
Russ Building,
San Francisco, California,

W. COBURN COOK,
Berg Building,
Turlock, California,

CHASE, BARNES & CHASE,
Title Insurance Building,
Los Angeles, California,

CLARK, NICHOLS & ELTSE,
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605 Market Street,
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Attorneys for the Appellants in the Four Companion Irrigation District Cases.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

Table of Authorities Cited

Cases

Codes and Statutes

No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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Appellants,

vs.

MERCED IRRIGATION DISTRICT,

Appellee.

(And 3 Companion Cases)

REFERENCE AND ANSWER TO CITATION BY APPELLEES OF PEOPLES STATE BANK v. IMPERIAL IRRIGATION DISTRICT.

(Filed by Appellants Pursuant to Permission of the Court.)

The appellees have called the Court's attention to a decision of the Supreme Court of California rendered on April 16, 1940.

Peoples State Bank v. Imperial Irrigation Dist., 99 Cal. Dec. 317.

The case is cited in the following companion cases:

Lindsay-Strathmore Irrigation District, No. 9206;

Palo Verde Irrigation District, No. 9133;
James Irrigation District, No. 9352;
Merced Irrigation District, No. 9242.

Appellants in reply desire to cite on their behalf, and to make a limited comment on, the *State Bank* case.

I.

By oral argument and in their briefs, appellants have urged that all functions of an irrigation district are governmental and that Section 83 of the bankruptcy act can not apply; first, for lack of power in Congress and, secondly, by the very terms of Section 83, which prohibits the making of any order that affects governmental functions.

In the *State Bank* case the Supreme Court of California summarizes its rulings made since the *Bekins* case:

> "While the exact language of the El Camino case is not to be found in the cases just cited, the principle enunciated therein was firmly established in this state by the three cases cited in the opinion in the El Camino case and many others of this and other appellate courts of this state, many of which are to be found cited in the Whiteman v. Anderson-Cottonwood Irrigation District case, supra. All of these cases had been decided long prior to the time when the Bekins case was before the Supreme Court of the United States."

At the oral argument we cited the following cases on the point that in dealing with state law the United States Courts will follow the state, and for that purpose, will change their position if necessary. For the court's convenience these cases are cited:

Elmendorf v. Taylor, 10 Wheat 152, 6 L. ed. 289;

Chicago M. St. P. & P. R. Co. v. Risty, 276 U. S. 567, 72 L. ed. 703;

Green v. Lessees of Neal, 6 Pet. 291, 8 L. ed. 403, 405;

Fairfield v. Gallatin Co., 100 U. S. 47, 25 L. ed. 544, 546;

Wade v. Travis Co., 174 U. S. 499, 43 L. ed. 1060, 1064.

It must be taken as settled, that the property of a district and all its functions, including of course its taxing power, are governmental.

And we respectfully point out that Section 83 prohibits any order that may interfere at all with state governmental functions. It is not comprehensible that a preliminary or final order made under Section 83 is not for the purpose of affecting the district and its property.

The proceeding is not a judicial proceeding if it could be held that the orders and the decree permitted by Section 83 have effect simply by state consent.

II.

The cited case makes it apparent that from the state's point of view the voluntary bankruptcy proceeding must be consented to through a state enactment. It adopts the theory that there is at least enough danger to public debts to say the state agency must not destroy its debts if the state does not grant authority to take the remedy of federal bankruptcy.

This emphasizes the second ground on which the plea of *res judicata* is based. The *Chicot Drainage District* case settles any doubt as to whether in the prior proceedings the trial Court had jurisdiction. (It could hardly be argued that this Court had no jurisdiction.) Take the case of Merced District, which has copied its first plan. There was jurisdiction of the subject matter and of the parties in the proceeding under Section 80. Following the *Ashton* case, the prior holding was: (1) that enforcing the plan through federal decree was unauthorized interference with state sovereignty; that the bonds were immune from change; (2) *the state, by virtue of the contract clause, was powerless to give consent to impairing the bonds by federal bankruptcy.*

Section 80 said the plan could be put into effect, if found fair, upon a hearing as full and complete as that of Section 83.

It is earnestly urged that it is not comprehensible that if a plan does interfere with state sovereignty on March 31st it does not on April 1st. And if the state's consent is not a cure-all on March 31st it is not on

April 1st. It seems conceded that except for time of enforcement, the plan is the same and also that, from a legal point of view, it is the same. It does unto appellants and the district's debts just what it did originally.

Dated, May 3, 1940.

Respectfully submitted,

BROBECK, PHLEGER & HARRISON,
HUGH K. MCKEVITT,
CHASE, BARNES & CHASE,
PETER TUM SUDEN,
DAVID FREIDENRICH,
W. COBURN COOK,
CLARK, NICHOLS & ELTSE,
CHAS. L. CHILDERS,

Attorneys for the Appellants in the Four Companion Irrigation District Cases.

No. 9355

United States

Circuit Court of Appeals

For the Ninth Circuit.

DONG AH LON,

Appellant,

vs.

MARIE A. PROCTOR, Commissioner of Immigration and Naturalization at the Port of Seattle, Washington,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division

PARKER PRINTING COMPANY, 545 SANSOME STREET SAN FRANCISCO

No. 9355

United States

Circuit Court of Appeals

For the Ninth Circuit.

DONG AH LON,

Appellant,

vs.

MARIE A. PROCTOR, Commissioner of Immigration and Naturalization at the Port of Seattle, Washington,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF COUNSEL:

KARL P. HEIDEMANN, Esq.,
Attorney at Law,
816 Central Building,
Seattle, Washington,
Attorney for Appellant.

J. CHARLES DENNIS, Esq.,
U. S. District Attorney,
222 Post Office Building,
Seattle, Washington,

GERALD SHUCKLIN, Esq.,
Assistant U. S. District Attorney,
222 Post Office Building,
Seattle, Washington,
Attorneys for Appellee. [1*]

*Page numbering appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States for the Western District of Washington, Northern Division.

No. 53

In the Matter of the Application of
Dong Ah Lon,
For Writ of Habeas Corpus.

PETITION FOR WRIT.

To the Honorable John C. Bowen, Judge of the Above Court:

Comes now your petitioner, Dong Ah Lon, and by this petition respectfully shows:

I.

That she is a citizen of the United States, being the foreign born daughter of a native born citizen of the United States.

II.

That in August (9th), 1938, your petitioner arrived at the port of Seattle from China, and then and there applied to the District Commissioner of Immigration at said port for admission to the United States, and at a hearing on said application by and before a Board of Special Inquiry convened for said purpose, applicant presented testimony and evidence tending to show, and proving her citizenship as aforesaid.

III.

That notwithstanding said facts, and the testimony and evidence before said Board proving the

United States citizenship of your petitioner as aforesaid, and notwithstanding that said testimony and evidence stood and now stands uncontroverted by any material testimony or evidence, said Board of Special Inquiry and said District Commissioner did on or about September 9th, 1938, deny applicant's right of admission to the United States and did refuse to admit her, [2] and made an order that she be rejected and deported to China, said order of denial and rejection and of deportation being made without any material evidence to support it, and based wholly and solely on the ground of alleged discrepancies in the testimony, which alleged discrepancies said Board conceded are not of great importance.

IV.

That thereafter a Petition for Writ of Habeas Corpus was filed and an Order to Show Cause entered, which Petition and Order were thereafter dismissed and a petition for reopening was addressed to the Honorable Secretary of Labor, which petition for reopening was granted and thereafter the matter was again presented to the Hon. Secretary of Labor and the Board of Review and the Hon. Secretary of Labor, on or about March 20, 1939, dismissed said appeal and affirmed said Order so appealed from, such dismissal and affirmance being with full knowledge by said Secretary of the rights of petitioner as aforesaid; said order of the Board of Special Inquiry and District Commis-

sioner and of said Secretary of Labor having been made arbitrarily, capriciously and wrongfully, and constituting a denial to petitioner of a fair and unbiased hearing in said Department; and your petitioner is without remedy except in this Court.

V.

That your petitioner is now detained, confined and restrained of her liberty by the Honorable Marie A. Proctor as District Commissioner of Immigration and Naturalization, at the Immigration Station at the Port of Seattle as aforesaid, within the jurisdiction of this Court, the same being for the pretended and purported reason that notwithstanding the facts above set forth, that petitioner is not entitled to admission [3] into the United States.

VI.

That said confinement and restraint is not under any process issued on any final judgment of a court of competent jurisdiction, nor for contempt of any court, nor upon any warrant issued from any court.

VII.

That your petitioner has deposited with the District Commissioner in charge of said Immigration Station at Seattle the sum of one hundred ($100.00) Dollars as maintenance charges of your petitioner pending this proceeding.

Wherefore, your petitioner prays that said District Commissioner of Immigration and Naturaliza-

tion be ordered to show cause herein why a Writ of Habeas Corpus be not issued herein, and that upon the hearing on said order to show cause, at a date to be fixed therein, that the issuance of a Writ of Habeas Corpus be directed, and said District Commissioner be commanded therein to have the body of your petitioner before this Court at the court room thereof at a time in said Writ to be fixed, there to do and receive what shall be then and there considered concerning your petitioner together with the time and cause of her detention.

HEIDEMAN & WALTHEW
Attorneys for Petitioner.

State of Washington
County of King—ss.

Karl P. Heideman, being first duly sworn on oath deposes and says: That he is the attorney for the above-named petitioner, that he has read the foregoing Petition, knows the contents thereof, and believes the same to be true.

KARL P. HEIDEMAN

Subscribed and sworn to before me this 28th day of October, 1938.

[Seal] GEORGE W. WILLIAMS
Notary Public in and for the State of Washington, residing at Seattle. [4]

[Endorsed]: Received a copy of the within Petition for Writ this 31 day of Mar. 1939. J. Charles Dennis, Attorney for Respondent.

[Endorsed]: Filed Mar. 31, 1939. [5]

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE.

It is made to appear from the petition of Dong Ah Lon herein filed that the said Dong Ah Lon is wrongfully and illegally imprisoned, confined and restrained of her liberty by the Honorable Marie A. Proctor as District Commissioner of Immigration and Naturalization at the United States Immigration Station at Seattle, within the jurisdiction of this Court said petition stating wherein such illegality consists; and it further appearing from said petition that petitioner has deposited with said District Commissioner the sum of one hundred ($100.00) Dollars as petitioner's maintenance charges pending this hearing; Now, Therefore, it is by the Court

Ordered that said Marie A. Proctor as District Commissioner of Immigration and Naturalization aforesaid show cause before this Court on the 17th day of April, 1939, at the hour of Ten o'clock a. m. of said day, or as soon thereafter as said petition may be heard, why a writ of habeas corpus should not issue herein, and why said petitioner should be further restrained of her liberty; and

Pending the further order of this Court the said District Commissioner be and she is hereby restrained and enjoined from deporting petitioner.

Done in Open Court this 31st day of March, 1939.

JOHN C. BOWEN

Judge

Presented by:

KARL P. HEIDEMAN

Of Counsel for Petitioner.

[Endorsed]: Filed Mar. 31, 1939. [6]

[Title of District Court and Cause.]

RETURN TO ORDER TO SHOW CAUSE.

To the Honorable John C. Bowen, Judge.

Comes now the respondent, Marie A. Proctor, as United States Commissioner of Immigration and Naturalization at the Port of Seattle, Washington, and, for answer and return to the Order to Show Cause entered herein, certifies that the said Dong Ah Lon has been detained by this respondent since the time she arrived from China at the Port of Seattle, Washington, to-wit: August 19, 1938, as an alien Chinese person not entitled to admission in the United States under the laws of the United States, pending a decision on her application for admission as a citizen on her claim of being a foreign-born daughter of a deceased citizen of the United States; that, at a hearing before a Board of Special Inquiry at the Seattle Immigration Station the said Dong Ah Lon failed to present satisfactory proof that she was or is a daughter of Dong Toy as claimed, and her application for admission in the United States was denied for that reason and (2) on the additional ground that she is an alien ineligible to citizenship not a member of any of the exempt classes specified in Section 13(c) of the Immigration Act of 1924, (8 U. S. C. A. 213); that the said Dong Ah Lon appealed from the said decision of the Board of Special Inquiry to the Secretary of Labor and thereafter the decision of

the Board of Special Inquiry was affirmed by the Assistant to the Secretary of Labor and the said Dong Ah Lon was ordered returned to China; that since the final decision of the Assistant to the Secretary of Labor, respondent has held, and now holds and detains the said Dong Ah Lon for return to China as an alien Chinese person not entitled to admission into the United States under the laws of the United States, and subject to return to China under the laws of the United States.

The original record of the Secretary of the Department of Labor, No. 55991/818, and all exhibits, both on the hearing before the Board of Special [7] Inquiry at Seattle, Washington, and on the submission of the record on appeal to the Secretary of Labor at Washington, D. C., in the matter of the application of Dong Ah Lon for admission into the United States, are hereto attached and made a part and parcel of this Return as fully and completely as though set *for* in detail.

Wherefore, respondent prays that the petition for a Writ of Habeas Corpus be denied.

MARIE A. PROCTOR

United States of America
Western District of Washington
Northern Division—ss.

Marie A. Proctor, being first duly sworn, on oath deposes and says: That she is the United States

Commissioner of Immigration and Naturalization at the Port of Seattle, Washington, and the respondent named in the foregoing Return; that she has read the foregoing Return, knows the contents thereof and believes the same to be true.

MARIE A. PROCTOR

Subscribed and sworn to before me this 12th day of April, 1939.

[Seal] (s) S. E. HOBAN

Notary Public in and for the State of Washington, residing at Seattle.

[Endorsed]: Filed May 5, 1939. [8]

In the District Court of the United States for the Western District of Washington, Northern Division.

No. 53

In the Matter of the Petition of
Dong Ah Lon
for Writ of Habeas Corpus.

ORDER DENYING WRIT.

This cause having duly come on for hearing before this Court on the 17th day of April, 1939, upon the Return of the United States Commissioner of Immigration and Naturalization to the Order to

Show Cause theretofore entered herein, the respective parties being represented by Karl P. Heideman and John F. Walthew for the petitioner and J. Charles Dennis and Gerald Shucklin, United States Attorney and Assistant United States Attorney, respectively, for the Respondent, and the Court being fully advised in the premises, having on the 6th day of July, 1939, directed that the Order to Show Cause be dismissed:

Now, Therefore, It Is By This Court Ordered, Adjudged and Decreed that the said Order to Show Cause be, and the same is hereby dismissed. It Is Also Further Ordered, Adjudged and Decreed that the Writ of Habeas Corpus as prayed for be, and the same is hereby denied: provided, however, that the petitioner may, within thirty (30) days, file notice of appeal, and, in the event that appeal be taken, and on condition that the petitioner shall deposit with the Commissioner of Immigration and Naturalization such sum or sums of money as may be required for said petitioner's maintenance at the Seattle, Washington, Immigration Station during the pendency of said Appeal, deportation shall be stayed pending the determination of said Appeal by the United States Circuit Court of Appeals for the Ninth Circuit, or by the United States Supreme Court should the cause be taken to that court on appeal.

Done in open court this 27th day of July, 1939.

JOHN C. BOWEN
United States District Judge

O. K. as to form
Copy received this 18th day of July, 1939.
HEIDEMAN and WALTHEW
Attorneys for Petitioner.

Presented by:
GERALD SHUCKLIN
Assistant United States Attorney [9]

[Title of District Court and Cause.]

NOTICE OF APPEAL.

Comes now the petitioner Dong Ah Lon by her attorneys Heideman and Walthew and hereby gives notice of appeal from that certain Order signed, entered and filed on the 27th day of July, 1939, by the above-entitled Court, said order denying petitioner's application for Writ of Habeas Corpus, to the United States Circuit Court of Appeals.

Dated this 24th day of August, 1939.

HEIDEMAN and WALTHEW
Attorneys for Petitioner.

Office & Postoffice Address:
816 Central Building,
Seattle, Washington
Seneca 4220

Received a copy of the within Notice of Appeal this 25th day of August, 1939.

J. CHARLES DENNIS
Attorney for Respondent.

[Endorsed]: Filed Aug. 25, 1939. [10]

[Title of District Court and Cause.]

STIPULATION FOR TRANSMISSION OF RECORD.

It is hereby agreed and stipulated by and between counsel for the petitioner and for the United States Commissioner of Immigration that the certified file and other records of the Department of Labor covering the exclusion and deportation proceedings against Dong Ah Lon, which are filed with the United States Commissioner of Immigration to the order to show cause, may be transmitted with the appellate record in this cause, and may be considered by the United States Circuit Court of Appeals in lieu of certified copies of the said original file and other records of the Department of Labor.

Dated this 24th day of October, 1939.

KARL P. HEIDEMAN
Attys for Appellant
J. CHARLES DENNIS
Attorney for United States Commissioner of Immigration.

[Endorsed]: Filed Oct. 24, 1939. [11]

[Title of District Court and Cause.]

ORDER FOR TRANSMISSION OF RECORDS.

Upon stipulation of counsel, it is by the Court

Ordered, and the Court does hereby order, that the Clerk of the above-entitled Court transmit the appellate record in the said cause, the certified original immigration file, and other records of the Department of Labor, covering and relating to the exclusion and deportation proceedings against Dong Ah Lon, which were filed with and made a part of the return of the United States Commissioner of Immigration to the order to show cause, directly to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, in order that the said original immigration file and records may be considered by the Circuit Court of Appeals in lieu of a certified copy of the same.

Done in open court this 24th day of October, 1939.

JOHN C. BOWEN

Judge

Presented by:

KARL P. HEIDEMAN

of Attorneys for Petitioner

816 Central Building

Seattle, Washington

O. K. as to form

GERALD SHUCKLIN

Asst. U. S. Attorney.

[Endorsed]: Filed Oct. 24, 1939. [12]

[Title of District Court and Cause.]

STIPULATION FOR EXTENSION OF TIME FOR FILING RECORD ON APPEAL AND DOCKETING THIS CAUSE IN THE CIRCUIT COURT OF APPEALS.

It is hereby stipulated by and between the parties hereto that the time for filing the record on the appeal and for docketing the above cause shall be extended to November 23rd, 1939.

J. CHARLES DENNIS
J. Charles Dennis, Attorney for United States Commissioner of Immigration.

GERALD SHUCKLIN
Gerald Shucklin, Assistant U. S. Attorney, Attorneys for Appellee.

KARL P. HEIDEMAN
of Attorneys for Appellant

[Endorsed]: Filed Oct. 24, 1939 [13]

[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR FILING RECORD ON APPEAL AND FOR DOCKETING CAUSE IN CIRCUIT COURT OF APPEALS.

This matter having come on to be heard before this Court upon the stipulation of the parties here-

to by their respective counsel for the extension of time for filing the record on the appeal and docketing the above cause in the Circuit Court of Appeals and the stipulation being on file herein and the Court being fully advised in the premises, Now, Therefore, It is hereby

Ordered that the time for filing the record on appeal in this cause and docketing the above action in the Circuit Court of Appeals is hereby extended to November 23rd, 1939.

Done in open court this 24th day of October, 1939.

JOHN C. BOWEN
Judge

Presented by:
KARL P. HEIDEMAN
of Attorneys for Appellant.

O. K. as to form:
GERALD SHUCKLIN
Assistant United States Attorney, of
Attorneys for Appellee.

[Endorsed]: Filed Oct. 24, 1939. [14]

[Title of District Court and Cause.]

PRAECIPE.

To the Clerk of Said Court:

Sir:

Please issue copies of papers for transcript on appeal, as follows:

1. Petition for writ of habeas corpus.
2. Order to show cause.
3. Return to order to show cause.
4. Order denying writ.
5. Notice of appeal.
6. Stipulation for transmission of record.
7. Order for Transmission of records.
8. Stipulation for extension of time for filing record on appeal and docketing this cause in the Circuit Court of Appeals.
9. Order extending time for filing record on appeal and for docketing cause in the Circuit Court of Appeals.
10. This praecipe. [15]

HEIDEMAN & WALTHEW
Attorneys for Appellant

Copy Received October 25, 1939.
J. CHARLES DENNIS
United States Attorney,
Attorney for Appellee.

[Endorsed]: Filed Oct. 25, 1939. [16]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO ORIGINAL DEPARTMENT OF LABOR RECORDS.

I, Elmer Dover, Clerk of the United States District Court for the Western District of Washington,

do hereby certify that I enclose herewith the original Department of Labor Records filed in the above entitled cause, which, pursuant to order of court dated October 24, 1939, are required to be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit as part of the appellate record herein, in lieu of a certified copy of same.

In witness whereof I have hereunto set my hand and affixed the official seal of said District Court at Seattle, in said District, this 1st day of November, 1939.

[Seal] ELMER DOVER,
Clerk,
United States District Court for the Western District of Washington.
By R. B. ALLEN,
Deputy. [17]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO TRANSCRIPT OF RECORD.

I, Elmer Dover, Clerk of the United States District Court for the Western District of Washington, do hereby certify that the foregoing typewritten transcript of record, consisting of pages numbered from 1 to 18, inclusive, *if* a full, true and complete copy of so much of the record, papers and other proceedings in the above and foregoing entitled

cause, as is required by praecipe of counsel filed and shown herein, as the same remain of record and on file in the office of the Clerk of the said District Court at Seattle, and that the same constitute the record on appeal herein from the Order Denying Petition for Writ of Habeas Corpus of said United States District Court for the Western District of Washington to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office by or on behalf of the appellant for making record, certificate or return to the United States Circuit Court of Appeals for the Ninth Circuit, to-wit:

Clerk's fees (Act Feb. 11, 1925) for making record, certificate or return, 26 folios at five cents	$1.30
Appeal Fee (Sec. 5 of Act)	
Certificate of Clerk to Transcript of Record	.50
Certificate of Clerk to Original Records	.50
Total:	2.30

I hereby certify that the above cost for preparing and certifying the record, amounting to $2.30, has been paid to me by the attorney for the appellant.

In Witness whereof I set my hand and affix the

seal of the said District Court, at Seattle, this 1st day of November, 1939.

[Seal] ELMER DOVER,
Clerk,
United States District Court,
Western District of Washington
By R. B. ALLEN,
Deputy. [18]

[Endorsed]: No. 9355. United States Circuit Court of Appeals for the Ninth Circuit. Dong Ah Lon, Appellant, vs. Marie A. Proctor, Commissioner of Immigration and Naturalization at the Port of Seattle, Washington, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division.

Filed Nov. 4, 1939.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals for the Ninth Circuit.

No. 9355

DONG AH LON

Appellant

vs.

MARIE A. PROCTOR, as Commissioner of Immigration and Naturalization for the Port of Seattle, Washington,

Appellee.

SPECIFICATION OF ERRORS RELIED UPON.

Now comes the appellant, Dong Ah Lon, through her attorneys Heideman and Walthew, and sets forth the errors she claims the District Court of the United States for the Western District of Washington, Northern Division, committed in denying her petition for a writ of habeas corpus, as follows:

I.

That the court erred in not granting the writ of habeas corpus and discharging the appellant, Dong Ah Lon, from the custody and control of Marie A. Proctor, Commissioner of Immigration and Naturalization at the Port of Seattle, State of Washington:

II.

That the court erred in not holding that the evidence adduced before the immigration authorities

was insufficient, in law, to justify the conclusion of the immigration authorities that the appellant was not a citizen of the United States:

III.

That the court erred in not holding that the appellant was a citizen of the United States and a Chinese person lawfully entitled to remain in the United States:

IV.

That the court erred in not holding that the immigration authorities acted unfairly and unreasonably in giving probative value to matters and things occurring outside of the regular hearing and not presented at any regular hearing as legal or competent evidence, or according petitioner, or her counsel, any opportunity of cross-examination or direct examination of any and all of the witnesses or of examination of appellant by counsel of appellant and in not allowing appellant to be represented by counsel when witnesses were examined, and in not allowing appellant to have counsel or a friend present at the time of her hearing:

V.

That the court erred in not holding that the appellant had met the burden of proof to establish her American citizenship:

Dated at Seattle, Washington, October 25, 1939.

HEIDEMAN and WALTHEW

Attorney for Appellant

Due service of copy of the foregoing Specification of Errors Relied Upon, hereby admitted this ..... day of October, 1939.

Received a copy of the within Specifications this 25th day of Oct. 1939.

J. CHARLES DENNIS
Attorney for U. S.

[Endorsed]: Filed Nov. 4, 1939. Paul P. O'Brien, Clerk.

[Title of District Court and Cause.]

DESIGNATION OF PORTIONS OF RECORD TO BE PRINTED.

To the Clerk of the above entitled Court:

The Appellant in the above entitled matter respectfully designates that all of the record be printed on the appeal in the above entitled matter:

Dated at Seattle, Washington, October 25, 1939.

HEIDEMAN and WALTHEW
Attorneys for Appellant

Received a copy of the within Designation this 25th day of Oct. 1939.

J. CHARLES DENNIS
Attorney for U. S.

[Endorsed]: Filed Nov. 4, 1939. Paul P. O'Brien, Clerk.

No. 9355

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

DONG AH LON, *Appellant*,

vs.

MARIE A. PROCTOR, Commissioner of Immigration and Naturalization at the Port of Seattle, Washington, *Appellee.*

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF FOR APPELLANT

KARL P. HEIDEMAN,
JOHN F. WALTHEW,
Attorneys for Appellant.

816 Central Building,
Seattle, Washington.

THE ARGUS PRESS, SEATTLE

No. 9355

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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vs.

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UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

The appellant respectfully contends that the District Court of the United States for the Western District of Washington, Northern Division, had jurisdiction of this cause below, and that the United States Circuit Court of Appeals for the Ninth Circuit has jurisdiction of this cause upon appeal to review the order in question under:

Section 41, subsection 22 of the United States Judicial Code, United States Code Anno-

[*Italics wherever used in this brief are ours*]

tated, Title 28, Section 41, subdivision 22, 643,

which reads as follows:

> "Suits under immigration and contract labor laws. Twenty-second. Of all suits and proceedings arising under any law regulating the immigration of aliens, or under the contract labor laws. (Mar. 3, 1911, c. 231, P. 24, par. 22, 36 Stat. 1093)."

Appellant respectfully contends that the petition for writ of habeas corpus, as set forth in pages 1 to 4, inclusive, of the transcript of record, shows the existence of the jurisdictions above referred to.

STATEMENT OF THE CASE

This is an appeal from an order of the District Court denying a writ of habeas corpus. The facts are as follows:

The appellant, Dong Ah Lon, is a Chinese woman now 22 years of age, who arrived in Seattle on August 9, 1938, and applied for admission to the United States, as the foreign born daughter of Dong Toy, a native born citizen of the United States. The only question presented is whether or not the appellant is the blood daughter of Dong Toy.

The appellant and two of her prior landed brothers, Dong Ball, who was admitted in 1920, and Dong Hong, who was admitted in 1935, were examined by the Board of Special Inquiry at Seattle on September 7, 8 and 9. The appellant had in the meantime from August 9, 1938, been held in custody be-

hind locked doors and barred windows at the Immigration Station at Seattle, and is still so held. The Board of Special Inquiry ordered appellant excluded, which order was affirmed by the Board of Review, at Washington, D. C., on appellant's appeal. Thereafter a petition for a writ of habeas corpus was filed by the appellant, which petition was voluntarily dismissed by appellant and the matter was reopened on appellant's petition in which she asked to be permitted to present further evidence and to again testify. A third prior landed brother of the appellant, Dong Yum, who was admitted in 1921, and another witness, Lee Ling Jung, were then examined by the Board of Special Inquiry at Seattle, on January 6, 1939, but the appellant was not allowed to again testify. The appellant was again ordered excluded, from which order she appealed to the Board of Review at Washington, D. C. Her appeal was there dismissed and thereafter her petition for writ of habeas corpus was denied by the District Court at Seattle, and this appeal therefrom follows.

The citizenship of Dong Toy, the alleged father of the appellant, now deceased, is conceded. It is also conceded that the father was in China at a time to have made the claimed relationship possible.

Dong Toy, the alleged father of the appellant, claimed in May, 1919, to have a daughter of approximately the name and birth date alleged by and for this appellant. The alleged father went to China in 1923 and died there the following year.

The appellant and her witnesses were in substan-

tial agreement on all questions of family history, there being minor disagreements therein concerning which the Board of Review stated:

> "The lack of agreement regarding these matters might be attributed to inaccuracy of memory on the part of the applicant whose mentality is indicated not to be either sharp or clear." (Decision Board of Review, October 20, 1938, p. 2)

The Board of Review bases its order of exclusion on the alleged disagreement between the testimony of appellant and her three brothers concerning the location of certain buildings and the identity and locations of the homes of residents of the village of Ping On, the home village of the appellant and her father and brothers.

ASSIGNMENTS OF ERROR

The court erred as follows:

(1) That the court erred in not granting the writ of habeas corpus and discharging the appellant, Dong Ah Lon, from the custody and control of Marie A. Proctor, Commissioner of Immigration and Naturalization at the Port of Seattle, State of Washington.

(2) That the court erred in not holding that the evidence adduced before the Immigration authorities was insufficient, in law, to justify the conclusion of the Immigration authorities that the appellant was not a citizen of the United States

(3) That the court erred in not holding that the appellant was a citizen of the United States and a

Chinese person lawfully entitled to remain in the United States.

(4) That the court erred in not holding that the Immigration authorities acted unfairly and unreasonably in giving probative value to matters and things occurring outside of the regular hearing and not presented at any regular hearing as legal or competent evidence, or according petitioner, or her counsel, any opportunity of cross-examination or direct examination of appellant by counsel of appellant and in not allowing appellant to be represented by counsel when witnesses were examined, and in not allowing appellant to have counsel or a friend present at the time of her hearing.

(5) That the court erred in not holding that the appellant had met the burden of proof to establish her American citizenship.

ARGUMENT

As the assignments of error involve substantially the same question, they will be argued together.

We wish to point out first the following facts:

1. The citizenship of Dong Toy (now deceased) the alleged father of the appellant is conceded.

2. The father, Dong Toy, "claimed in May, 1919, to have a daughter of approximately the name and birth date alleged by and for this applicant." (Decision of Board of Review, page 1, October 20, 1938)

3. On every occasion since May, 1919, that any

member of this family has testified, this appellant has been named as a daughter of Dong Toy and sister of the three witnesses who testified they were her brothers. These occasions have been numerous. (Dong Toy, San Francisco file 12017/20194; Dong Yum, San Francisco file 35428/13/23, May 18, 1921; Dong Hong, San Francisco file 29879/3-11; Dong Ball, San Francisco file 35428/14-5, and the other files included in the record.)

4. That the appellant is a woman, and seldom is a woman claimed by Chinese for immigration purposes.

Thus the existence of a daughter of Dong Toy, named Dong Ah Lon, has been established since 1919, a period of 20 years.

This prior claim over a long period of time is very important and has been so recognized by our courts in many cases, among which are *Ng Yuk Ming v. Tillinghast* (C.C.A. 1) 28 F. (2d) 547, in which the court said:

> "It thus appears that in 1914 when the appellant was two years old, and thirteen years before he applied for admission to this country, the alleged father at Seattle testified before the immigration authorities that he had a son bearing the name of the applicant, who was born September 25, 1912, which he confirmed on every other occasion upon which he was called upon to testify. *It is clear that in 1914 the alleged father had no reason for stating that he had such a son if it was not the fact.* The question of relationship therefore, on the undisputed evi-

dence, narrows itself down to the question whether the applicant is the Ng Yuk Ming that was born of the union of Ng Ling Fong and Moy Shee on September 25, 1912. All three witnesses who gave testimony in this case are in agreement upon this point. The discrepancies relied upon by the immigration authorities relate to collateral matters, all of which are of such a trifling nature as to furnish no substantial evidence for reaching a contrary conclusion."

and *U. S. ex rel. Lee Kim Toy v. Day*, 45 F. (2d) 206, at page 207, in which the court said:

"The applicant claims to be Lee Shew Hong. *It would be pushing beyond the bounds of reason to suppose that Lee Kim Toy in 1915 concocted a story of a fictitious son for use fifteen or more years later* * * *.

"The convincing character of such antecedent evidence has been pointed out by the courts in cases of this type. *Johnson v. Ng Ling Fong* (C.C.A.) 17 F. (2d) 11, 12; *U. S. ex rel. Leong Ding v. Brough* (C.C.A.) 22 F. (2d) 926, 927. The Boards of Special Inquiry, in my opinion, did not give this proof the weight which it deserves. * * *"

The Immigration authorities have many times said that Chinese always have large families and they are always all sons, no daughters. This appellant is a woman, and the statement of the court in *Mason ex rel. Lee Wing You v. Tellinghast*, 27 F. (2d) 580, as follows:

"* * * And it is also of much significance that in 1914 and 1922 the father stated that he had such a son. *It is hardly conceivable that the*

father had at these times laid his plans to bring in an outsider as his son and made a false announcement of paternity as a first step in his intended fraud."

is all the more applicable since the claimed child is a daughter.

All witnesses (except Lee Lin Jung, who testified he did not know appellant) readily identified her and her photograph, and she in turn readily identified them (Pages 7, 8, 12, 13, 16 and 24, Seattle file No. 7030/11310).

Except in the arbitrary procedure developed in Chinese cases, the most forceful testimony concerning relationship is the direct testimony of the members of the family group. Here, coupled with the identification above mentioned, the direct testimony of the witnesses themselves, and the establishment of the existence of a daughter of Dong Toy of same name and age as appellant, we have the very distinct resemblance of Dong Ah Lon and her brother Dong Hong and her father Dong Toy. (See photographs of these persons.) This constitutes the strongest possible evidence of relationship.

Even the Board of Special Inquiry in the first paragraph on page 19 of Seattle file 7030/11310 states as follows:

"Dong Toy departed from San Francisco January 6, 1916, for China, and returned on May 17, 1919, at which time he claimed marriage to Hom Shee, second wife, CR 5-2-15 (March 18, 1916) and described a daughter, Lan Hai, born CR 5-12-26. *This child is presumed to be the present*

applicant, although there is a difference in the name and date of birth. The Board concedes the essential trip."

The difference in names referred to is easily explained when one takes into consideration that Chinese names when written in the English language follow the phonetic spelling and that spelling depends on the particular interpreter at the time. The difference of 10 days in the birth date, one being the 16th, the other the 26th, must be attributed either to a typographical error or one in interpreting.

The appellant and her three witnesses testify in substantial accord and there is no discrepancy about the names and ages of the appellant's father, mother, granduncle, two sisters-in-law, seven nephews, one niece, and her five brothers.

She agrees with her witnesses on such very unusual items, which do not appear unless witnesses are testifying from actual knowledge of the facts and from their own experience, as that her father died at night, that he was first buried in a hill two (2) lis west of the home village, that he was later reburied in a hill a little farther west. The witnesses agree that a bust photograph of their father in American clothes hangs on the living room wall. They agree on the number of visits by the two older brothers to China, and very singularly all of the appellant's brothers testify that her hair was long when they last saw her in China, although appellant's hair is now bobbed, and she states she had it bobbed just before she left home on her journey for the United

States. She outlines in full the quarters occupied by various members of the household or home in China.

She agrees with her brothers perfectly as to the description and location of the house in which she is living and agrees concerning the landmarks surrounding the village.

All of the discrepancies mentioned by the Immigration officials and upon which they rely for rejecting the appellant deal with matters that are not connected with the family and have no bearing on the question of relationship. The location of the houses of the various persons living in the village and the disagreements as to who lived in which house and the location of the village school which the appellant did not attend have no bearing on the question of relationship. See *Johnson v. Damon* (C.C.A.) 16 F. (2d) 65; *Gung You v. Nagle* (C.C.A.) 34 F. (2d) 848; *One Din v. Ward,* 20 F. Supp. 424; *Ng Yuk Ming v. Tillinghast* (C.C.A.) 28 F. (2d) 548; *Hom Chung v. Nagle* (C.C.A.) 41 F. (2d) 126.

In testifying that the school was west of the village the appellant probably had reference to the school she attended which was in fact west of the village and not to the school attended by her brothers to the east.

Such instances as this make clear the arbitrary action of the Board of Special Inquiry in refusing to allow the appellant to again testify when the case was reopened. It would then have been a simple matter to have definitely ascertained to which school she referred. Many of the instances seized upon by

the Board are of a similar nature. The Board seems to prefer to have such discrepancies unexplained.

In considering this record it must be borne in mind that the appellant has not had many advantages. She has attended school for only two years. There was no special place for girls to live as was the custom in many Chinese villages, and she lived at home. She was confined largely to the house and to the household duties. In addition thereto the record is replete with indications that the appellant is not bright and that she has misunderstood many of the questions. Even the Board of Review itself states as follows (Decision Board of Review, October 20, 1938, pp. 1 and 2):

> "The first group of features noted as adverse to the appellant's claim are spoken of by the Chairman of the Board of Special Inquiry in his summary as instances of 'lack of knowledge of family history.' The applicant and her witness alleged brothers alleged brothers agree that the deceased alleged father was married twice, first to a woman named Jee Shee and after her death to a woman named Hom Shee. According to the testimony of the alleged brothers, the three oldest sons in the family were given birth by Jee Shee. The applicant testifies that so far as she knows Jee Shee never bore any children and that her mother Hom Shee told her that she was Hom Shee's fourth child. She later on recall said that she did not know who was the mother of her three older brothers. In view of the fact that the applicant gives her mother Hom Shee's age as 47 and her oldest brother's age as 39, which would mean that if Hom Shee were the

mother of this oldest brother, she would have given birth to him when she was eight years old, or seven years old in American reckoning, would seem to make this feature *chiefly an indication of the applicant's ignorance or stupidity.* In any event, she could have knowledge of the facts only through hearsay. The applicant's witness alleged brothers testify in accordance with previously given testimony that the alleged father's mother's name was Hom Shee. The applicant testifies that according to her understanding her paternal grandmother's name was Chin Shee. It would seem that one should know the family name of one's paternal grandmother but here again the fact that the paternal grandmother is said to have died many years ago might make this a lack of knowledge which the applicant could have only through hearsay since while the witness alleged brothers say that the paternal grandmother's name appears upon ancestral papers kept in their home, there is no showing that the applicant despite her two year school attendance is able to read. Two other disagreements between the applicant and her witness alleged brother Dong Hong involving matters of family association are noted, one as to the length of time Dong Loon, an older alleged brother of the applicant, who was excluded and deported in September, 1925, stayed in the home village before going to the Philippines and the other as to whether the alleged brother Dong Hong was last in China between 1931 and 1934, or as the record shows between April, 1929, and December, 1930. *The lack of agreement regarding these matters might be attributed to inaccuracy of memory on the part of the applicant*

whose mentality is indicated not to be either sharp or clear."

In addition to the instances italicized in the Board of Review's decision, above, there are many other instances of her lack of understanding.

"Q Who told you you were born CR 5-12-16?

A My *stepmother.*

Q Can you explain why your father testified at San Francisco May 17, 1919, that he had a daughter, Lan Hai, born CR 4-12-26?

A I don't know. I learned my birthdate from my *stepmother.*

Q What is the name of your father's second wife?

A Hom Shee, 47 years old. * * *

Q How many children were born to Hom Shee by your father?

A Five sons, one daughter.

Q *Are you the daughter?*

A Yes."

On page 3 the appellant testified:

"Q You state that you are the fourth child born to *Hom Shee.* How do you determine this?

A My *mother* told me."

In other words the applicant is recorded as referring to her own mother as her step-mother.

Another example of the applicant's mental slowness is to be found on page 3, where she testified:

"Q Is Yow Fee older than Yow Hah?

A Yes.

Q How do you know that?

A I should know. I live in the same house.

Q If somebody said Yow Hah was older than Yow Fee, would he be mistaken?

A That's right, Yow Fee is younger.

Q You just told us that Yow Fee was older than Yow Hah?

A I just made a mistake."

On the same page, the appellant testifies that her brother, Dong Hong, has *three* sons, and then proceeds to describe *four* as follows:

"A Dong Hong, marriage name, Oh Tun, 37 years old, living in Seattle, wife is Chin Shee, natural feet, has *three* sons and one daughter, You Foon, 19 years old, not married, attending school in our village, You Goon, 16, also attending school in the village, You Hin, twin to You Goon, in the same school. *There is another boy*, You Gok, 9 years old, also attending school. Girl, Dong Ah Haw, 8 years old, not attending school. They occupy the small door side bedroom of our house."

Another example, on page 4, the appellant testifies:

"Q Did you ever see Dong Loon?

A Yes, I saw him. He came to the United States more than ten years ago.

Q Have you seen him since that time?

A *No.* * * *

Q Did Dong Loon return to your home before leaving for Manila?

A Yes.

Q How long did he remain at home before going to Manila?

A For about three years before he went to Manila."

An example of misunderstanding or faulty interpretation is found on page 5 and page 17:

"Q What lies directly in front of your village?

A Fishpond in front and beyond that the Seo Hoy *Village.* * * *

Q What is the name of the *stream* near your village?

A Seo Hoy, about half a li in front of our village.

Q Is there a village called Seo Hoy?

A No."

SUMMARY AND CONCLUSION

Now, in considering the above remember we have here a girl who has had only two years of schooling in all of her life, a girl who has always lived in a small village in a country where girls are unimportant and treated virtually as slaves in this class of family, who comes here at a time when that home and that village are disrupted by war, when everything is in a state of confusion. She appears before strangers in a strange country where everything is foreign and confusing. She must speak through a strange interpreter. Her natural fright and nervousness is heightened by the fact that she is held a prisoner, locked behind bars for a month unable to see anyone that she knows, or to whom she can talk as a friend. Taking into consideration all of these factors it is natural that there is confusion in her mind and that these discrepancies, which in no way bear upon her relationship to Dong Toy, her father, and to her brothers, have appeared.

It is strange to us that although the duty of the immigration authorities is as much to establish citizenship as to exclude the applicant, that the Board of Special Inquiry and the Board of Review absolutely ignore the matters that are favorable to the appellant and point out only the unfavorable ones. It is true that the immigration authorities are the triers of the facts but they cannot arbitrarily and capriciously ignore facts favorable to the appellant and emphasize the unfavorable facts as they have done here.

To show as one example the unreasonableness of the Immigration authorities, they cite as a discrepancy the fact that the applicant's brother Dong Hong went to China April 26, 1929, and returned December 10, 1930, and that the appellant testifies that he went home in 1931 and returned in 1933, although the record shows that Dong Hong was in China for almost two years and the appellant testifies that he was at home when his nine year old son was born and was not at home when his eight year old daughter was born. Obviously had the Immigration authorities stopped to think they could have seen that the appellant was mistaken as to the date but that she knew full well when Dong Hong was at home. All one needs to do is to subtract nine years from the date when the applicant testified and it will show that Dong Hong was there in 1929 and when his son was born and subtract eight years from the date when the applicant testified to show that Dong Hong had left in 1930, when his daughter was born. Thus the Immigration authorities pick out only those portions

of the testimony that are unfavorable to the appellant and do not consider the portions of the record that are favorable to her. Nor do they try to set her straight although it is obvious that the appellant is unthinkingly mistaken.

It is apparent from studying this record that the Immigration authorities were not carrying out the duty imposed upon them which duty is outlined in the case of *Low Hu Yuen v. U. S.* (C.C.A.) 9 F. (2d) 327, at page 331:

> "The purpose of the hearing is to inquire into the citizenship of the applicant, not to develop discrepancies which may support an order of exclusion, regardless of the question of citizenship."

In *Kwock Jan Fat v. White*, 253 U. S. 454, at p. 464 (64 L. ed. 1010) Mr. Justice Clark stated in an opinion of the Supreme Court:

> "The acts of Congress give great power to the Secretary of Labor over Chinese Immigrants and persons of Chinese descent. It is a power to be administered, not arbitrarily and secretly, but fairly and openly, under the restraints of the *tradition and principles of free government* applicable where the *fundamental rights of men are involved*, regardless of their origin or race. It is the province of the courts, in proceedings for review, within the limits amply defined in the cases cited to prevent abuse of this extraordinary power. * * * *It is better that many Chinese Immigrants should be improperly admitted than that one natural born citizen of the United States should be permanently excluded from this country.*"

By the testimony of every member of this family from 1917 to the present date it has been unequivocally established that Dong Toy had a daughter of the age of this appellant. It is a well known fact that female children are unimportant in China. They are not even mentioned in many Chinese records. Because of this the Immigration authorities have times innumerable pointed out as an argument for exclusion that Chinese seeeking to have children admitted to this country have many sons, never any daughters. This seems to be recognized as a legitimate argument on the part of such officials. Here, however, we have a father, Dong Toy, for twenty years claiming before the Immigration Officials that he has a daughter. This claim has been reiterated ever since, not only by himself but by his male children. Using the arguments so frequently advanced by the Board it is certain that Dong Toy in 1917 did not fraudulently claim to have a daughter for immigration purposes. Had the declaration been fraudulent it would have involved a son, not a daughter. If, therefore, it is fair for the Board to continuously urge as a reason for exclusion that the Chinese fraudulently claim only sons, is it not a legitimate argument in favor of the claimed relationship that this father for 20 years has claimed the existence of a daughter?

No prior attempt has been made to admit this daughter to this country. Dong Toy is now dead and it having been forever established that he had but one daughter it follows that but one person can be admitted to this country as such daughter. All of these

facts in the light of the record lead to the conclusion that this appellant is the individual claimed by Dong Toy as a daughter for 20 years and that the claimed relationship has been established.

It should also be taken into consideration that the appellant is being brought to this country to marry Lee Lin Jung, who is, to use the words of the Board of Review (in their decision of March 21, 1939) "shown to be a man of good reputation and his testimony to have the applicant become his wife in order to care for his seven motherless children removes any possibility of an immoral intent in the attempt to have the applicant into the United States." Thus the brothers who have testified cannot be accused of testifying falsely for some personal gain. They have no interest in the matter other than to have their sister admitted as a citizen, as she should be.

There is nothing more important to any of us today than our citizenship in the United States, yet it is almost beyond our power to conceive how important that citizenship is to a person like the appellant. She is a girl from a country where even under normal conditions girls have few privileges or rights, a country that today is not under normal conditions but is torn by war, a country overrun by an army of an enemy having little regard for property or even life of the inhabitants of the invaded country. This girl might as well be condemned to death as to be sent back to China. As a matter of fact we may well say that she will go back to a life more horrible than death. Certainly under these circumstances where but one daughter has ever been claimed we submit

that as heretofore quoted: "It is better that many Chinese immigrants should be improperly admitted than that one natural born citizen of the United States should be permanently excluded from this country" (*Kwock Jan Fat v. White*, 253 U. S. 454-464, 64 L. ed. 1010).

We respectfully submit that the appellant has carried the burden imposed upon her and that she should be admitted to this country as a citizen thereof.

Respectfully submitted,

KARL P. HEIDEMAN,
JOHN F. WALTHEW,
Attorneys for Appellant.

No. 9355

In the United States Circuit Court of Appeals

For the Ninth Circuit

DONG AH LON,

Appellant,

vs.

MARIE A. PROCTOR, as Commissioner of Immigration and Naturalization at the Immigration Station at the Port of Seattle,

Appellee.

Upon Appeal From the District Court of the United States for the Western District of Washington, Northern Division

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF FOR APPELLEE

J. CHARLES DENNIS,
United States Attorney,

GERALD SHUCKLIN,
Assistant United States Attorney,
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Immigration and Naturalization Service,
(On the brief).

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SUBJECT INDEX

CASES CITED

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CODES AND STATUTES CITED

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BRIEF FOR APPELLEE

Statement of the Case

The subject of this proceeding is a woman of the Chinese race who claims the name of DONG AH LON. She states that she was born in Ping On village, China,

on a Chinese date corresponding to January 9, 1917. She arrived from China at Seattle, Washington, on August 9, 1938, and applied for admission into the United States as a citizen thereof by virtue of being a foreign-born child of a deceased native citizen of the United States named Dong Toy. Following the usual hearing prescribed by law in such cases, in which the appellant and her alleged three brothers testified concerning the relationship claimed, her application for admission was denied by a regularly constituted Board of Special Inquiry at the United States Immigration Station, Seattle, on the ground that she failed to establish the claim of being a daughter of the man claimed to be her father, and (2) on the additional ground that she is an alien ineligible to citizenship, not a member of any of the exempt classes specified in Section 13(c) of the Immigration Act of 1924 (8 U. S. C. A. 213). From this decision the appellant appealed to the Secretary of Labor, who dismissed the appeal and directed that she be returned to China. Thereafter, the appellant applied to the District Court of the United States for the Western District of Washington, Northern Division, for a Writ of Habeas Corpus, and alleged in a general form that the hearing was arbitrary, capricious, wrongful, and constituted a denial of a fair and unbiased hearing. It is con-

ceded that during the life of the alleged father of appellant he was a citizen of the United States. It is also conceded that if the appellant is a blood daughter of her alleged father she is entitled to admission with the status of a citizen under R. S. 1993 (8 U. S. C. A. 6). The sole question at issue is whether the appellant did satisfactorily establish such claim of relationship.

LAW AND AUTHORITIES

Section 23 of the Immigration Act of 1924 (8 U. S. C. A. 221) places the burden of proof upon applicants of all classes for admission into the United States. Additionally, under the Chinese Exclusion laws Chinese applicants for admission are required to prove right to enter and the government is not required to present any evidence to disprove their assertions. *Lew Bow Sing vs. Proctor*, 9 Cir., 83 Fed. (2) 546, and authorities cited.

Section 17 of the Immigration Act of February 5, 1917 (8 U. S. C. A. 153) provides that Boards of Special Inquiry shall have authority to determine whether applicants for admission shall be allowed to land or shall be deported, and that

> "* * * In every case where an alien is excluded from admission into the United States under any

> law or treaty now existing or hereafter made, the decision of a board of special inquiry adverse to the admission of such alien shall be final, unless reversed on appeal to the Secretary of Labor; * * *."

As said with respect thereto in the last Chinese discrepancy case reviewed by the Supreme Court, *Quon Quon Poy v. Johnson*, 273 U. S. 352, 47 Sup. Ct. 358:

> "It is clear, however, in the light of the previous decisions of this court, that when the petitioner, who had never resided in the United States, presented himself at its border for admission, the mere fact that he claimed to be a citizen did not entitle him under the Constitution to a judicial hearing; and that unless it appeared that the Departmental officers to whom Congress had entrusted the decision of his claim, had denied him an opportunity to establish his citizenship, at a fair hearing, or acted in some unlawful or improper way or abused their discretion, their finding upon the question of citizenship was conclusive and not subject to review, and it was the duty of the court to dismiss the writ of habeas corpus without proceeding further."

In a condensed form the attitude of the Supreme Court is definitely expressed in *Tulsidas v. Collector*, 262 U. S. 258:

> "We think, rather it will leave the administration of the law where the law intends it should be left; to the attention of officers made alert to attempts at evasion of it, and instructed by experience of the fabrications which will be made to accomplish evasion."

As said in *Yep Suey Ning v. Berkshire*, 9 Cir., 73 Fed. (2) 751:

> "'It must be borne in mind that this court must not substitute its judgment for that of the immigration boards on matters of fact."

And in *Lum Sha You v. United States*, 9 Cir., 82 Fed. (2) 83:

> "In considering the evidence, it is not sufficient that we might have reached a different decision."

The Immigration authorities are exclusive judges of weight of testimony and credibility of witnesses appearing before them, and there is no indication of unfairness if a witness is not believed. *Chin Ching v. Nagle*, 9 Cir., 51 Fed. (2) 64; *Mui Sam Hun v. United States*, 9 Cir., 78 Fed. (2) 615; *Jung Yen Loy v. Cahill*, 9 Cir., 81 Fed. (2) 813; *Wong Choy v. Haff*, 9. Cir., 83 Fed. (2) 984.

In *Del Castillo v. Carr*, 9 Cir., 100 Fed. (2) 339, the Court said:

> "If there is any substantial evidence to support it, the order of the Assistant Secretary of Labor cannot be nullified through the writ of habeas corpus." (Authorities cited.)

ADMINISTRATIVE FINDINGS AND CONCLUSIONS

The findings and conclusions of the local Board of Special Inquiry are shown on pages 18-22, 32-33, of

the certified record of the Secretary of Labor, Exhibit No. 55991/818. The findings and conclusions of the Board of Review at Washington, D. C., approved by the Assistant to the Secretary of Labor, are shown on the blue sheets in the same Exhibit, and are quoted below:

"55991/818 Seattle October 20, 1938.

In re: DONG AH LONG, Age 21

This case comes before the Board of Review on appeal from denial of admission as a daughter of a (deceased) native. The relationship is at issue.

Attorney George E. Tolman has filed a brief.

Dong Toy, the alleged father of the applicant, claimed in May, 1919, to have a daughter of approximately the name and birthdate alleged by and for this applicant. The alleged father went to China in 1923 and is said to have died there the following year. Dong Hong, an older alleged brother of the applicant, who was admitted in 1920 and was last in China between April, 1929, and December, 1930, and Dong Ball, a younger alleged brother, who was admitted in August, 1935, and has not since returned to China, have testified on the applicant's behalf.

The first group of features noted as adverse to the applicant's claim are spoken of by the Chairman of the Board of Special Inquiry in his summary as instances of "lack of knowledge of family history." The applicant and her witness alleged brothers agree that the deceased alleged father was married twice, first to a woman named Jee Shee and after her death to a woman named

Hon Shee. According to the testimony of the alleged brothers, the three oldest sons in the family were given birth by Jee Shee. The applicant testifies that so far as she knows Jee Shee never bore any children and that her mother Hom Shee told her that she was Hom Shee's fourth child. She later on recall said that she did not know who was the mother of her three older brothers. In view of the fact that the applicant gives her mother Hom Shee's age as 47 and her oldest brother's age as 39, which would mean that if Hom Shee were the mother of this oldest brother she would have given birth to him when she was eight years old or seven years old in American reckoning, would seem to make this feature chiefly an indication of the applicant's ignorance or stupidity. In any event, she could have knowledge of the facts only through hearsay. The applicant's witness alleged brothers testify in accordance with previously given testimony that the alleged father's mother's name was Hom Shee. The applicant testifies that according to her understanding her paternal grandmother's name was Chin Shee. It would seem that one should know the family name of one's paternal grandmother but here again the fact that the paternal grandmother is said to have died many years ago might make this lack of knowledge which the applicant could have only through hearsay since while the witness alleged brothers say that the paternal grandmother's name appears upon ancestral papers kept in their home, there is no showing that the applicant despite her two year school attendance is able to read. Two other disagreements between the applicant and her witness alleged brother Dong Hong involving matters of family association are noted, one as to the length of time Dong Loon,

an older alleged brother of the applicant, who was excluded and deported in September, 1925, stayed in the home village before going to the Philippines, and the other as to whether the alleged brother Dong Hong was last in China between 1931 and 1934 or as the record shows between April, 1929, and December, 1930. The lack of agreement regarding these matters might be attributed to inaccuracy of memory on the part of the applicant whose mentality is indicated not to be either sharp or clear.

For the other discrepancies which the testimony shows it does not appear possible to make any such excuse for these involve neither matters of hearsay nor memory of events in the past but matters about which there should be agreement as a matter of course if the applicant and her witness alleged brothers had had their home in the same house in the same village as claimed. The applicant and her witness alleged brothers agree that she was born and has lived all the twenty-one years of her life in the Ping On village. She and these alleged brothers describe this village as consisting of fifteen dwellings and one schoolhouse, the houses arranged in five rows of three houses each, the village facing north with the so-called head to the west and the so-called tail to the east and she and these witnesses agree that their home is the first house on the second row from the head or west side of the village. The applicant states that the village schoolhouse is located at the head or west side of the village and that the village toilet structures are behind the schoolhouse at the head or west side of the village and that there never was a schoolhouse at the east or tail side of the village. The witness alleged brothers agree that the schoolhouse is at the other

side, that is at the east or tail side of the village and that the toilets are at the west side not behind the schoolhouse but at the opposite side of the village and these witness alleged brothers testify that there has never been a schoolhouse in the location which the applicant gives for the schoolhouse at the west or head side of the village. While it is true that the schoolhouse in which the applicant claims to have gone to school for a couple of years is located elsewhere than in the home village, yet it would seem unreasonable to believe that she and her alleged brothers could have had their home in the same tiny village when they so definitely disagreed as to whether the schoolhouse is at the same side of the village where the toilet structures are or at the opposite side of the village.

Also, it seems unreasonable to believe that this applicant and her alleged brothers could have had their home in the same small village and disagree as to the make-up and location of all of the alleged neighboring households in the dwellings said to be nearest to that in which the applicant and her alleged brothers claim to have had their home. The lack of agreement between the applicant and her witnesses regarding these nearest village residents is fully detailed by the Chairman of the Board of Special Inquiry and this would seem to make it unreasonable to believe that the applicant and her witnesses have been members of the same household as claimed.

It is not believed that the evidence reasonably establishes that this applicant is a daughter of her alleged father.

It is, therefore, recommended that the appeal be dismissed.

L. Paul Winnings
Chairman

Concur:

T. B. Shoemaker
Deputy Commissioner

So Ordered:

Turner W. Battle
Assistant to the
Secretary."

"55991/818 Seattle March 21, 1939.

In re: DONG AH LON, Age 21.

This case in which appeal from denial of admission as a daughter of a (deceased) native was dismissed on October 26, 1938, because the relationship was not found satisfactorily established and in which reopening for further investigation was authorized on December 15, 1938, comes again before the Board of Review after a second denial of admission.

Attorney George E. Tolman has filed a supplementary brief.

As reference to the memorandum of October 20, 1938, recommending dismissal of the appeal, will show, Dong Hong and Dong Ball, one older and one younger alleged brother of the applicant appeared in the original examination to testify on her behalf. Discrepancies which appeared to be irreconcilable with the claim of family association between the applicant and those alleged brothers and so with the claim of relationship here at issue were disclosed which in the opinion of the Board of Review required recommending dismissal of the appeal. Since the case was reopened, Dong Yum, the oldest alleged brother of the applicant, and Lee Len, her intended husband, have appeared to testify. While Dong Yum has

added to the previous affirmations of alleged brothers of the applicant his identification of her as a daughter of the deceased alleged father, his testimony substantially agreeing with that of the two alleged brothers who appeared in the original examination is as much in conflict with that given by the applicant as was the testimony of those two alleged brothers. The witness Lee Len is shown by a communication from the City Clerk of San Mateo, California, to be a man of good reputation and his testimony regarding his desire to have the applicant become his wife in order to care for his seven motherless children removes any possibility of suspicion of an immoral intent in the attempt to have the applicant enter the United States. However, this witness states that he knows nothing whatever concerning the truth of the claim of relationship here at issue beyond what he has been told by an alleged brother of the applicant. Thus, in the opinion of the Board of Review no evidence presented since the case was reopened warrants a reversal of the previous decision.

It is, therefore, recommended that the order dismissing the appeal stand.

L. Paul Winnings
Chairman

Concur:
T. B. Shoemaker
Deputy Commissioner
So Ordered:
Turner W. Battle."

ARGUMENT

IMMIGRATION RECORDS OF ALLEGED RELATIVES OF APPELLANT. Exhibit 12017/20194 contains the Immigration history of the appellant's alleged father. He claimed birth in this country, and made several trips to China. He last left the United States during April, 1922, and is reported to have died in China during January, 1924.

Exhibit 29879/3-11 relates to Dong Hong, alleged son of Dong Toy, and alleged half-brother of appellant, who was originally admitted to this country in 1920. He has since made two trips to China and returned to this country the last time on December 10, 1930. He made the application to bring the appellant to this country.

Exhibit 35428/13-23 relates to Dong Yum, alleged second son of Dong Toy, and alleged half-brother of appellant, who was originally admitted to this country in 1921. He made one trip to China, departing in 1933 and returning July 31, 1935.

Exhibit 24091/6-21 shows that Dong Loon, alleged third son of Dong Toy, and alleged half-brother of appellant, applied for admission in 1925. He failed to prove the relationship claimed and was returned to China.

Exhibit 36863/6-16 relates to Dong Yuen, alleged fourth son of Dong Toy, and full brother of appellant, who applied for admission in 1936. He failed to prove the relationship claimed and following denial of a Writ of Habeas Corpus was returned to China.

Exhibit 35428/14-5 refers to Dong Ball, alleged fifth son of Dong Toy, and alleged full blood brother of appellant, who was admitted to this country in 1935.

The witnesses are Dong Hong, Dong Ball and Dong Yum. Lee Lin Jung, or Lee Len, testified that he expected to marry the appellant, but otherwise did not know anything about the appellant.

OBJECT OF APPELLANT COMING TO UNITED STATES. The appellant states "When the papers were made out for me to come here I heard from the neighbors that I was to be married to a LEE man here, but I didn't hear anything about it from my mother." (32). Dong Yum made out the identification affidavit or application to bring the appellant to this country, which is made an Exhibit, and testified that he expected the appellant to marry and go to school (31). Lee Len or Lee Lin Jung testified that he had tentatively arranged with Dong Yum to marry the appellant (28).

CREDIBILITY OF WITNESSES. Exhibit 24091/6-21 shows that Dong Hong and Dong Yum concocted a scheme in the attempt to land a contraband Chinese named Dong Loon in this country as their brother who was found to be fraudulent and was returned to China in 1925. Both of them testified in behalf of Dong Loon.

Exhibit 36863/6-16 shows that Dong Hong and Dong Ball conspired together in the attempt to land in this country a contraband Chinese named Dong Yuen, who was found to be fraudulent and was returned to China in 1937 following dismissal of petition for a Writ of Habeas Corpus.

These three witnesses are now attempting to land the appellant in this country as their sister. They are completely discredited on account of their activities in attempting to land in this country two contraband Chinese, unquestionably for a financial consideration. As their testimony has been rejected the appellant is left without any evidence in support of her claim of being a daughter of her alleged father.

The practice of coaching has been repeatedly recognized by the courts. See *Quock Ting v. United States*, 140 U. S. 417.

The decision in the case of *Quan Wing Seung v. Nagle*, 9 Cir., 41 Fed. (2) 59, is directly in point and should be controlling here without consideration of any other point in the case. The decision consists of but 17 lines, the controlling part reads:

> "The record is replete with alleged discrepancies, but, in view of the false testimony given by the alleged father in an effort to secure the admission of an alleged son, we can not say that a fair hearing was denied because the immigration authorities did not believe his testimony in the present instance."

And in *Chin Ming Hee v. Proctor*, 9 Cir., 97 Fed. (2) 901:

> "Without the consideration of a number of other discrepancies in the testimony of the alleged father, we think the inconsistency between the statement of the father in 1918 that he had only one son five years of age, and the statement in 1930 that he then had twin sons, justified the rejection of his entire testimony. The only other testimony to support the claim of the appellant that he was the son of his alleged father is that of the appellant himself. While this testimony was competent (Lee Hin v. U. S., 9 Cir., 74 F. 2d 172) it is not entitled to great weight."

Also in *Wong Ying Wing v. Proctor*, 9 Cir., 77 Fed. (2) 136:

> "Owing to the discrepancies in the testimony of both the alleged parents and the alleged brother, they are all discredited as witnesses." (Authorities cited). "If this testimony is rejected

there is left no evidence that appellant was born in this country except his own statement to that effect."

DISCREPANCIES. The petitioner claims to have lived in the 1st house, 2nd row from the head in Ping On village, with all members of the family while in China, continuously from the time of her birth in 1917 until she left for this country. She claims to have attended school for two years (2, 7). The petitioner and her witnesses are in agreement that there are fifteen houses, three on each of five rows, in the village. Diagram of the village drawn under the supervision of the petitioner is marked Exhibit A. Therefore, the petitioner should be familiar with the lay-out of the village and be acquainted with the occupants of the houses in such a small village, if she had lived there.

LOCATION OF SCHOOL AND TOILETS. The petitioner says that the village school, named Tung Shen, is located at the head or West end of the village and that the various toilets are also located at the head or West end of the village and just back of the school; that there is no building of any kind outside of the house rows at the tail or East end of the village (5, 16, 17).

The three alleged brothers of petitioner are in agreement that the village school, Tung Shen, is at the tail or East end of the village and that the toilets are all located at the head or West end of the village; in other words, the school is at one end of the village and the toilets are at the opposite end (10, 14, 15, 30).

OCCUPANTS OF 1ST HOUSE 1ST ROW FROM HEAD, OPPOSITE PETITIONER'S LARGE DOOR. The petitioner says that Dong Sing Bor, about 70, no occupation, lived in this house as long as she can remember, with a son named Gim Wah, 17 or 18 years, attending school in the village, and a son named Gim Choon, who is now in the shoe business in Chuk Hom market, and a daughter named Ngoot Yung, 18, who was married during the 2nd month of 1938 and now lives away (6). On reexamination she says that Gim Choon is married and has one son, Chuk Ying, 7 or 8, and a daughter, Lee Ngon, about 11 years old; that Gim Choon never had a brother or sister; that she does not know Gim Wah; that Ngoot Yung, girl, lives in the 2nd house 1st row from the tail; that Dong Sing Bor never lived on the 5th row (17).

Dong Hong places another family in this house. He says that Bok Sing, wife, daughter Mee Ngon, 18 or 19, his father whose wife is deceased, always lived

in this house; that Dong Sing Bor always lived on the 3rd lot 5th row from the head; never had a son named Gim Wah or a daughter named Ngoot Yung (11, 12).

Dong Ball and Dong Yum testified in agreement with Dong Hong that Dong Bok Sing, wife, daughter Mee Ngon, 19, and father have always lived in this house and never in any other house (15, 30, 31).

OCCUPANTS OF IST HOUSE 3RD ROW FROM HEAD, OPPOSITE PETITIONER'S SMALL DOOR. The petitioner says that Bok Gong's mother lives alone in this house; that Bok Gong came to the United States 7 or 8 years ago and is now about 18 years old; that she does not know a man in the village named Dong Hen Woo or a girl named Dong Ngoon Tew (7). On reexamination she says that Bok Gong is a rice farmer in the village and never lived in the United States (17); that no girls live in this house (18).

Dong Hong says that Hen Woo, wife, two daughters, Ngoon Tew, 18 or 19, have always lived in this house, the other daughter, Ngoon Yung, about 23, is now married and lives away from the village (12), and is corroborated by Dong Yum and Dong Ball, except that Hen Woo is now in Canada (15, 31).

Dong Hong and Dong Ball say they never heard of Bok Gong, but are acquainted with Bok Ung, who lives in another house in the village (12, 15).

OCCUPANTS OF 2D HOUSE 2D ROW FROM HEAD, JUST BACK OF PETITIONER'S HOUSE. The petitioner says that Bok Sing, single, over 20 years, rice farmer, lives in this house with his mother and no other person (6); that Bok Sing never lived in the 1st house 1st row from the head; that Bok Sing never had a daughter named Dong Mee Ngon and never heard of a daughter named Gui Gim (7, 17).

Dong Hong, Dong Ball and Dong Yum are all in agreement that Tung Hee, rice farmer, wife and a daughter named Gui Gim, 18 to 20, and father, have always lived in this house, and never lived in the 3d house on the row (11, 15, 30).

OCCUPANTS OF 3D HOUSE 2D ROW FROM HEAD. The petitioner says that Tung Hee, a little older than she, never had a wife, rice farmer, lives in this house with his widowed mother; never lived in the 2nd house on the row (6, 17, 18).

Dong Hong, Dong Ball and Dong Yum are in agreement that Fong Moon and his family live in this house; that they have two sons, Bing Foo, over 20, rice farmer in the village, and another son named

Bing Suie, who is now living away from the village (11, 15, 30).

Thus, the petitioner is in total disagreement with her three alleged brothers as to which end of the village the school is located and the occupants of the nearest four houses to the house in which she claimed to have always lived. In fact, she is in total disagreement with her alleged three brothers concerning the membership and residence of every family about which she was questioned. Similar discrepancies, but less severe, were pointed out as material in the following excluded cases:

Woon Sun Seong v. Proctor, 9 Cir., 99 Fed. (2) 285;

Chin Ming Hee v. Proctor, 9 Cir., 97 Fed. (2) 901;

Hom Lay Jing v. Nagle, 9 Cir., 57 Fed. (2) 653.

REPLY TO MISCELLANEOUS POINTS RAISED IN BRIEF FOR APPELLANT. It is conceded that there is some agreement between the appellant and her witnesses, but it has been held that a multitude of agreement does not necessarily prove the relationship claimed.

Wong Shong Been v. Proctor, 9 Cir., 79 Fed. (2) 881, 298 U. S. 665;

Weedin v. Yee Wing Soon, 9 Cir., 48 Fed. (2) 36;

Nagle v. Quon Ming Him, 9 Cir., 42 Fed. (2) 451.

The mere fact that the alleged father on May 17, 1919, claimed a daughter of the name and age claimed by the appellant is no evidence of fact, and there is no acceptable evidence in view of the discrepancies and the testimony of the discredited witnesses that the appellant is the same person claimed by her alleged father in 1919. Asserted citizenship must be proved to be of any value. *Sing Tuck. v. United States*, 194 U. S. 161; *Chin Bak Kan v. United States*, 186 U. S. 193. In the reported cases it is shown that the great majority of Chinese applicants for admission excluded and returned to China claimed names and ages that corresponded to those previously claimed by their alleged fathers. On pages 18 and 19 it is stated that the appellant was claimed by her father for 20 years, but such allegation is inconsistent with the facts. The appellant claims birth on January 9, 1917. The alleged father could not have mentioned a daughter when appearing before the Immigration Service since his departure during April, 1922, and he is reported to have died in China during January, 1924.

The testimony indicates that the appellant was capable of testifying intelligently, but even though she might not be intellectually smart is no excuse. On this point we cite *Kaoru Yamataya v. Fisher*, 189 U. S. 86, 23 Sup. Ct., 615, in re the deportation of a Japanese woman:

> "Suffice it to say, it does not appear that appellant was denied an opportunity to be heard. * * * If the appellant's want of knowledge of the English language put her at some disadvantage in the investigation conducted by that officer, that was her misfortune, and constitutes no reason, under the acts of Congress, or any rule of law, for the intervention of the court by habeas corpus."

The appellant cites *Kwock Jan Fat v. White*, 253 U. S. 454, on pages 17, 20. That case is completely distinguishable on the facts, and the further fact the appellant there claimed to be a native-born citizen of the United States, whereas the appellant here admits birth in China. The said case with two others are cited in *Tod v. Waldman*, 266 U. S. 113, 45 Sup. Ct., 87, and with respect thereto the court said:

> "In those cases the single question was whether the petitioner was a citizen of the United States before he sought admission, a question of frequent judicial inquiry."

The appellant's brief presents the inescapable suggestion that she should be admitted because of sym-

pathy (P. 19). There is no provision in the Immigration or Chinese Exclusion laws for the admission of an inadmissible alien on the ground of sympathy. As said in *Yep Suey Ning et al. v. Berkshire*, 9 Cir., 73 Fed. (2) 752:

> "Nor is there any undue hardship being visited upon these two boys by the orders for their deportation to their native land."

CONCLUSION

The appellant was accorded a fair and impartial hearing by the Immigration authorities; no evidence offered in her behalf was omitted, and she failed to sustain the burden of proof cast upon her by the statutes to establish her claim of relationship to her alleged father. No question of law is raised. The immigration officials did not abuse the discretion committed to them by law. There is substantial evidence to support the excluding decision. Therefore, the decision of the Secretary of Labor is final and conclusive. None of the allegations set forth in the petition for the Writ of Habeas Corpus have been proved,

and it is not shown that the District Court erred in dismissing the Writ.

It is respectfully submitted that the judgment of the District Court should be affirmed.

J. CHARLES DENNIS,
United States Attorney,

GERALD SHUCKLIN,
Assistant United States Attorney,
Attorneys for Appellee.

J. P. SANDERSON,
Immigration and Naturalization Service,
(On the brief.)

No. 9401

United States

Circuit Court of Appeals

For the Ninth Circuit.

P. M. JACKSON, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

Appellant,

vs.

E. A. LYNCH, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division

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INDEX.

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Los Angeles, California. [1*]

CITATION

United States of America—ss.

To E. A. Lynch, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt, Greeting:

You are hereby cited and admonished to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be held at the City of San Francisco, in the State of California, within forty days from the date hereof, pursuant to an order

*Page numbering appearing at foot of page of original certified Transcript of Record.

allowing appeal filed on Nov. 17, 1939, in the Clerk's Office of the District Court of the United States, in and for the Southern District of California, in that certain cause No. 34521-J Bcky. Central Division, Wherein P. M. Jackson, Trustee in Bankrtupcy for the Estate of Leonard J. Woodruff, a bankrupt, is appellant and you are appellee to show cause, if any there be, why the decree, order or judgment in the said appeal mentioned, should not be corrected, and speedy justice should not be done to the parties in that behalf.

Witness, the Honorable Geo. Cosgrave United States District Judge for the Southern District of California, this 17th day of November, A. D. 1939, and of the Independence of the United States, the one hundred and sixty-fourth.

GEO. COSGRAVE
U. S. District Judge for the Southern District of California

Service of a copy of the foregoing Citation is acknowledged this 17th day of November, 1939. Received copies of the following: Petition for Appeal, Order Allowing Appeal, Assignment of Errors, Praecipe.

RUPERT B. TURNBULL &
LEONARD J. MEYBERG
By RUPERT B. TURNBULL
By H. JODREY
Attorney for Appellee E. A. Lynch

[Endorsed]: Filed Nov. 17, 1939. [2]

In the District Court of the United States, Southern District of California, Central Division

In Bankruptcy

No. 34521-J

In the Matter of
LEONARD J. WOODRUFF,
Bankrupt.

CREDITOR'S PETITION IN BANKRUPTCY

To the Honorable Judges of the District Court of the United States in and for the Southern District of California, Central Division:

The petition of M. E. Heiser respectfully represents and shows to this Court:

I.

That the above named Leonard J. Woodruff, of Los Angeles, California, has had for more than ten years last past and now has his home and place of residence at 2446 Inverness Avenue and his domicile in the City of Los Angeles, County of Los Angeles, and within the Southern District of the State of California, Central Division of this Court, and for a longer period of the six months just immediately preceding the filing of this petition than in any other judicial District; that said Leonard J. Woodruff has for more than ten years last past had his principal place of business at 4532 Hollywood Boulevard, running through to Sunset Boulevard in the City of Los Angeles,

County of Los Angeles, and within the Southern District of the State of California, Central Division of this Court, and for a longer portion of the six months just past immediately preceding the filing of this petition than in any other judicial district.

II.

That the said Leonard J. Woodruff owes debts to the amount in excess of $1,000.00, and is not a wage-earner or a farmer, nor [3] engaged principally in the tillage of the soil. That the said Leonard J. Woodruff is the owner and operator of an extensive business situate at 4532 Hollywood Boulevard, running through to Sunset Boulevard, Los Angeles, California, known as "Woodruff Antique Stores," and is a merchant and dealer in antiques and jewelry, and was so engaged during all of the times herein mentioned in this petition and has been so engaged for more than ten years last past.

III.

Your petitioner is a creditor of said Leonard J. Woodruff, having a provable claim against him fixed as to liability and liquidated in amount, said claim being in the sum of $278,631.71. That your petitioner, as a creditor, has no securities held by him, and said indebtedness is entirely unsecured. That all of said indebtedness aforesaid is past due and unpaid, and said liability of $278,631.71 has been fixed by a judgment of this Honorable Court

both as to liability and amount; that the nature and extent of the petitioner's said claim is as follows: That in the year 1929 Leonard J. Woodruff wrongfully and fraudulently converted to his own use property of the petitioner consisting of raw sapphires, opals and zircons of the then value of $164,000.00, which liability has been established by this Court in an action in this District Court wherein petitioner, M. E. Heiser, was and is the plaintiff, and said Leonard J. Woodruff was and is a defendant, under the terms of which judgment of this Court the value of said sapphires was and is fixed at the sum of $164,000.00, the liability of Leonard J. Woodruff for interest has been and is fixed in the sum of $113,036.71, and costs of said action taxed against Leonard J. Woodruff in favor of petitioner in the sum of [4] $1,595.00, making said total judgment in the aggregate sum of $278,-631.71.

IV.

That within four months last past, immediately preceding the filing of this petition, to-wit, more particularly within thirty days next immediately preceding the filing of this petition, the said Leonard J. Woodruff committed an act of bankruptcy in that heretofore on or about the 5th day of July 1939 he did admit in writing this inability to pay his debts and his willingness to be adjudicated a bankrupt.

V.

Petitioner alleges that on the 5th day of July 1939, thereafter continuously, and now, the said Leonard J. Woodruff had, exclusive of indebtedness to his relatives and exclusive of his indebtedness to his employees, in number creditors less than twelve.

VI.

And for a Separate, Second and Distinct Act of Bankruptcy, your petitioner alleges that within ninety days last past, immediately preceding the filing of this petition, the said Leonard J. Woodruff did while insolvent, conceal and secrete, remove, and permit to be removed, concealed and secreted, raw sapphires, opals and zircons of the reasonable market value of over $30,000.00; that the said concealment and secretion of the same was had by delivery and depositing said raw sapphires, opals and zircons in the name of Howard Woodruff, a son of Leonard J. Woodruff, all with intent to hinder, delay and defraud the creditors of said Leonard J. Woodruff including this petitioner; and that by such concealment, transfer and secreting of said raw sapphires, opals and zircons your petitioner as a creditor was hindered, was delayed and was defrauded, and that at all of the times herein mentioned the said Leonard J. Woodruff was and is insolvent, and is unable to pay his debts as they mature. [5]

Wherefore, your petitioner prays that service of this petition with a subpoena may be made upon

said Leonard J. Woodruff, as provided in the Acts of Congress relating to Bankruptcy, and that he be adjudicated by the Court to be a bankrupt within the purview of said Act.

M. E. HEISER,
Petitioning Creditor.

L. J. MEYBERG,
RUPERT B. TURNBULL,
Attorneys for Petitioning Creditor. [6]

United States of America
State of California
County of Los Angeles—ss.

M. E. Heiser, the petitioner above named, does hereby make solemn oath that the statements contained in the foregoing petition subscribed by him are true.

M. E. HEISER.

Subscribed and sworn to before be this 13th day of July, A. D. 1939.

[Seal]

PAUL JOSEPH,
Notary Public in and for the
County of Los Angeles, State
of California.

[Endorsed]: Filed July 13, 1939. [7]

[Title of District Court and Cause.]

CREDITOR'S PETITION FOR THE APPOINTMENT OF A RECEIVER

Comes now M. E. Heiser, a creditor of Leonard J. Woodruff, and makes this his application and petition for the appointment of a Receiver in the above entitled matter, and in support of such application shows to the Court as follows:

That this Court, by and through one of its Judges, the Honorable Geo. Cosgrave, did on or about March 20, 1939 render its judgment in favor of your petitioner, M. E. Heiser as plaintiff and against the alleged bankrupt herein as defendant, ordering and giving judgment in favor of petitioner and against the said Leonard J. Woodruff in the total sum of $278,631.71; that the said judgment is based upon the wrongful, fraudulent and illegal conversion by the said Leonard J. Woodruff of certain raw sapphires; and that the liability of the said Leonard J. Woodruff has become and is a fixed liability in the sum so referred to; that no part of the said judgment has been paid; that at the request of counsel for the said Leonard J. Woodruff your petitioner, through his counsel, stipulated for a stay of execution on said judgment to July 6, 1939.

That immediately prior to the expiration of the said stay of execution the said Leonard J. Woodruff departed from the jurisdiction of this court and is now absent from the jurisdiction of this court; that your petitioner, as a judgment creditor,

has no security of any kind for the payment of said judgment, the whole of which is now due, owing and unpaid, and that your petitioner is a wholly unsecured creditor of the said Leonard J. Woodruff. [8]

That an emergency exists making it absolutely necessary for the appointment of a Receiver in this proceeding to take charge of the assets of Leonard J. Woodruff, marshal said assets, preserve the same from loss and destruction or dissipation by the agents of Leonard J. Woodruff, insure the same, and hold same until *until* the adjudication and subsequent election of a Trustee in Bankruptcy herein; and that the following assets, among others, are in the jurisdiction of this Court situated in the Southern District of California, Central Division, to-wit:

(a) Raw sapphires, opals and zircons of the value of about $30,000.00 now in the possession of Howard Woodruff, a son of Leonard J. Woodruff, in connection with which the said Howard Woodruff has testified in this court that he is the agent of his father, Leonard J. Woodruff, and holds the same for and subject to the orders of his father, Leonard J. Woodruff. Petitioner alleges that upon orders from Leonard J. Woodruff, the said Howard Woodruff will dispose of said raw sapphires, opals and zircons and place the same beyond the jurisdiction of this court, and that there is every probability of the said Leonard J. Woodruff's giving such order.

(b) That Leonard J. Woodruff is the owner of a large, extensive and successful place of business, situate at 4532 Hollywood Boulevard, running through to Sunset Boulevard, Hollywood, Los Angeles County, State of California, known as the "Woodruff Antique Stores," which place of business is stocked with an extensive store of antiques of great value, to-wit, estimated in excess of $20,000.00. That it is absolutely necessary that some person in authority and with authority be placed in charge of said business, with authority to operate the same if same can be operated at a profit, and otherwise to store said stock of goods; and petitioner alleges that in this regard an emergency exists, and it is necessary that a receiver be placed in charge of [9] said business so that said stock may not be dissipated, removed, transferred and concealed.

That such stock of goods, as well as said raw sapphires, opals and zircons have not been attached, and no Sheriff or other official is in possession or charge thereof.

That no previous application has been made to this Court for the appointment of a Receiver herein, and so far as is known to petitioner no Receiver has been appointed by any Court.

Wherefore, your petitioner prays that an order may be made herein appointing some competent person as Receiver, with authority to marshal the assets of Leonard J. Woodruff, the bankrupt, within the jurisdiction hereof, to take possession

thereof, insure the same, and with additional authority to operate the business of the bankrupt providing same can be operated at a profit.

Dated July 13, 1939.

(Signed) M. E. HEISER,
Petitioner.

L. J. MEYBERG, (Signed)
RUPERT B. TURNBULL,
Attorneys for Petitioner.

[Endorsed]:

State of California
County of Los Angeles—ss.

M. E. Heiser being by me first duly sworn, deposes and says: that he is the petitioner in the above entitled action; that he has read the foregoing petition and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters that he believes it to be true.

M. E. HEISER.

Subscribed and sworn to before me this 13th day of July, 1939.

[Notarial Seal]
PAUL JOSEPH,
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed Jul. 13, 1939. [10]

[Title of District Court and Cause.]

ORDER APPOINTING RECEIVER

On verified petition duly filed, asking for the appointment of a Receiver in the above entitled matter, and it appearing satisfactorily therefrom that it is absolutely necessary for the preservation of the assets of said bankrupt that a Receiver should be appointed, upon motion of Rupert B. Turnbull Attorney for said petitioner,

It is Ordered That E. A. Lynch of Los Angeles, California, be and he is hereby appointed Receiver of all property of whatsoever nature and wheresoever located, now owned by or in the possession of said bankrupt, and of all and any property of said bankrupt and in possession of any agent, servant, officer or representative of said bankrupt, care for, inventory, insure, segregate and move all assets of said bankrupt until the appointment and qualification of the Trustee herein, and with the further authority to collect such accounts receivable as are due to said estate and with further authority to conduct the business and sell the same as a going concern, if it can be done with benefit to said estate, and said Receiver is authorized to do all and any such acts and take all and any such proceedings as may enable him forthwith to obtain possession of all and any such property; and

It Is Further Ordered That the Duties and Compensation of said Receiver are hereby specifically extended beyond those of [11] a mere custodian within the meaning of Section 48 of the Bankruptcy

Act to embrace the conduct of the business and marshalling of assets, preparation of inventories, collection, sale and disposition of accounts and notes receivable, and conduct of business of said bankrupt as hereinabove specifically authorized, and

It Is Further Ordered that all persons, firms and corporations including said bankrupt, and all attorneys, agents, officers and servants of said bankrupt forthwith deliver to said Receiver all property of whatsoever nature and wheresoever located, including merchandise, accounts, notes and bills receivable, drafts, checks, moneys, securities and all other choses in action, account books, records, chattels, lands and buildings, life and fire and all other insurance policies in the possession of them or any of them, and owned by said bankrupt, and said bankrupt is ordered forthwith to deliver to said Receiver all and any such property now in the possession of said bankrupt; and

It Is Further Ordered that all persons, firms and corporations, including all creditors of said bankrupt, and representatives, agents, attorneys and servants of all such creditors, and all sheriffs, marshalls, and other officers, and their deputies, representatives and servants are hereby enjoined and restrained from removing, transferring, disposing of or selling or attempting in any way to remove, transfer or dispose of, sell or in any way interfere with any property, assets or effects in possession of said bankrupt or owned by said bank-

rupt, and whether in possession of any officers, agents, attorneys or representatives of said bankrupt, or otherwise and all said persons are further enjoined from executing or issuing or causing the execution or issuance or suing out of any Court of any writ, process, summons, attachment, replevin, or any other proceeding for the purpose of impounding or taking possession or interfering with any property owned by or in possession of [12] said bankrupt or owned by said bankrupt, and whether in possession of any agents, servants or attorneys of said bankrupt, or otherwise; and

It Is Further Ordered that the said Receiver is directed and authorized, as provided under the Postal Laws and Regulations of the United States, to receive all mail matters addressed to the above named bankrupt; and

It Is Further Ordered that before entering upon his duties, said Receiver shall furnish a bond conditioned for the faithful performance of his duties, with a good and sufficient surety or sureties, in the sum of $20,000.00.

Dated: This 13th day of July, 1939.

WM. P. JAMES,

Judge.

[Endorsed]: Filed Jul. 13, 1939. [13]

[Title of District Court and Cause.]

ANSWER OF ALLEGED BANKRUPT

To the Honorable Judges of the District Court of the United States in and for the Southern District of California, Central Division:

A petition having been filed in the above court on the 13th day of July, 1939, praying that your respondent, the alleged bankrupt above named, be adjudged a bankrupt, your respondent now appears and answers to the said petition as follows:

I.

Respondent denies the allegations contained in paragraphs numbered 1, 5 and 6 of the petition.

II.

Respondent denies the allegations of paragraph 2 of said petition, except the allegations that he owes debts to an amount in excess of $1,000.00 and is not a wage earner or engaged principally in the tillage of soil and that he is owner of the business situated at 4532 Hollywood Boulevard, running through to Sunset Boulevard, Los Angeles, California, known as "Woodruff Antique Stores."

III.

Respondent admits the allegations of the third paragraph of the said petition insofar as they allege the rendering of a judgment against this respondent in favor of the petitioner by the district court of the United States, Southern District of California, *Dentral* Division, but respondent says

that said judgment was rendered by default, without proper service of summons upon this respondent, that petitioner never had a just cause of action against this respondent, that said judgment is without merit and without right; that this [14] respondent has a good and valid defense to petitioner's purported cause of action; that said judgment should, and respondent believes will, be vacated, set aside and held for naught by the court rendering the same.

IV.

Respondent demands a jury trial upon the allegations contained in the sixth numbered paragraph of said petition, which allegations are specifically denied.

V.

Respondent admits that he is a bankrupt and in connection therewith shows to the court that on the 5th day of July, 1939, he filed his voluntary petition in bankruptcy in the district court of the United States for the Eastern District of Oklahoma, which petition was docketed therein as cause in Bankruptcy No. 7623, and on the 5th day of July, 1931, the Honorable Eugene Rice, judge of said court in bankruptcy, made and entered an order in said cause adjudicating this respondent a bankrupt and made and entered in connection therewith an order of general reference, referring said matter to the Honorable George F. Clark, Referee in Bankruptcy, a copy of said order of adjudication in bankruptcy and order of reference being

hereto attached marked "Exhibit A" and made a part hereof; a certified copy of said order having been filed for record in the office of the county recorder of Los Angeles County, California on July 7, 1939, at 2:46 P. M., and having been duly recorded and now being of record in said office in book 16725 at page 201. In pursuance of said order of adjudication and reference the Honorable George F. Clark as referee in bankruptcy set the first creditors' meeting to be held at Ardmore in Carter County, State of Oklahoma, and in said district on the 20th day of July, 1939, at 10 o'clock A. M. and on the 5th day of July, 1939, said Honorable George F. Clark, as such referee, mailed to the petitioner herein and his attorney at the last known address of the petitioner and his attorney notice of said creditors' meeting. Said creditors' meeting was held in compliance with said notice and at the time and place appointed; the petitioner herein appeared by and through his attorneys, Leonard J. Meyberg and Rupert B. Turnbull of Los Angeles, California, and T. G. Gibson of Ardmore, Oklahoma; the petitioner filed with the referee in bankruptcy at said creditors' meeting his unsecured claim [15] based upon the judgment set out in the third numbered paragraph of his petition herein and upon which this proceeding is predicated and the petitioner by and through his attorney, Hon. T. G. Gibson, participated in the selection of a trustee in bankruptcy and at said meeting Hon. P. M. Jackson of Ardmore, Oklahoma, was

elected trustee in bankruptcy and the said P. M. Jackson has duly qualified as such trustee and is now the duly elected, qualified and acting trustee in bankruptcy of and for this respondent.

VI.

This respondent has had for more than ten years last past and now has his resident, domicile, and principal place of business in the County of Carter, State of Oklahoma and in the Eastern District thereof; the respondent has never resided or had his domocile or principal place of business in Los Angeles County, California, or within the jurisdiction of this court; the respondent has for more than 20 years spent some portion of his time within the jurisdiction of this court on account of and for his health and upon the instructions of his attending physician. This court does not have jurisdiction to entertain this proceeding, the district court of the United States for the Eastern District of Oklahoma having jurisdiction thereof and on account of the matters and things herein set out this proceeding should be dismissed.

VII.

Respondent says that he has more than three creditors and at the creditors meeting held, as aforesaid, at Ardmore in the County of Carter, State of Oklahoma, on the 20th day of July, 1939, there were filed and allowed the claims of more than 20 unsecured creditors, a list of which claims,

showing the names and addresses of the claimant, the amount for which claim was approved, and a brief statement of the nature of the claim, is hereto attached, marked "Exhibit B" and made a part hereof.

VIII.

Respondent further says that even if it should be held and ordered that this court has jurisdiction in this matter than, nevertheless respondent says that the district court of the United States for the Eastern District of Oklahoma, the court in which respondent filed his voluntary petition in bankruptcy July 5, 1939, and in which he was adjudicated a bankrupt on said date, [16] is the court which can proceed with the administration of this bankrupt's estate with the greatest convenience to the parties in interest and to the best interest of the creditors, and this respondent is filing with the district court of the United States for the Eastern District of Oklahoma, his application for an order under general order No. 6, asking the district court of the United States for the Eastern District of Oklahoma, to determine that it is the court which can proceed with the administration of his bankrupt estate with the greatest convenience to the parties in interest, and under said general order No. 6, all proceedings in this court must be stayed until the determination by the district court of the United States for the Eastern District of Oklahoma of the question raised by said applica-

tion. A copy of said application being hereto attached, marked "Exhibit C".

Wherefore, having fully answered, your respondent prays that this proceeding be stayed pending a determination of the question of convenience under general order No. 6 by the district court of the United States for the Eastern District of Oklahoma, and that if upon the determination of said question that court holds that it is the court in which this bankrupt's estate can be administered with the greatest convenience to the parties in interest that this proceeding then be dismissed; but if the district court of the United States for the Eastern District of Oklahoma determines that this court should proceed with the administration of this bankrupt's estate, then this respondent prays that the issues herewith presented be determined by this court and a jury as herein prayed for.

LEONARD J. WOODRUFF,
Respondent.

HIRAM E. CASEY,
CHAMPION, CHAMPION & FISCHL,
Attorneys for Respondent. [17]

State of Oklahoma
County of Carter
Eastern District of Oklahoma

I, Leonard J. Woodruff, the respondent named in the foregoing answer, do hereby make solemn oath that the statements therein are true, according to my knowledge, information and belief.

LEONARD J. WOODRUFF.

Subscribed and sworn to before me this the 25th day of July, 1939.

[Seal] J. WILLIAM CARNES,
Notary Public,
Ardmore, Okla.

My Commission Expires: Feby. 26, 1943. [18]

"EXHIBIT A"

In the District Court of the United States for the Eastern District of Oklahoma.

In Bankruptcy No. 7623

In Re LEONARD J. WOODRUFF, Ardmore, Oklahoma, Bankrupt.

At Muskogee, Oklahoma, in said District, on the 5th day of July, A. D. 1939, before the Honorable Eugene Rice, Judge of said Court in Bankruptcy, the petition of Leonard J. Woodruff that he be adjudged bankrupt, within the true intent and meaning of the acts of Congress relating to Bankruptcy, having been heard and duly considered, the said Leonard J. Woodruff is hereby declared and adjudged bankrupt accordingly.

It Is Ordered that said matter be referred to George F. Clark one of the Referees in Bankruptcy of this Court, to take such further proceedings herein as are required by said acts of Congress.

(Signed) EUGENE RICE,
Judge.

United States of America
Eastern District of Oklahoma—ss.

I, W. V. McClure, Clerk of the District Court of the United States of America for the Eastern District of Oklahoma, do hereby certify the foregoing to be a true, full, and correct copy of an Order of Adjudication in Bankruptcy as the same appears of record in said Court.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Court, at my office in Muskogee, Oklahoma, in said District, this 5th day of July, A. D. 1939.

[Seal] W. V. McCLURE,
Clerk.
By ELLIS QUIETT,
Deputy.

[Endorsed]: Filed July 5, 1939, W. V. McClure, Clerk, U. S. District Court. [19]

"EXHIBIT B"

Name of Claimant	Address	Nature of Claim	Amount
C. F. Dillard	Ardmore, Okla.	Labor	$500.00
Waldo Duncan	Ardmore, Okla.	Labor	15.00
Sale Coffey	Ardmore, Okla.	Labor & Taxes	50.00
Lon Peevy	Ardmore, Okla.	Labor	44.00
E. L. Franklin	Ardmore, Okla.	Labor & Expenses	40.00
F. Dillard	Ardmore, Oklahoma	Labor	100.00
Carter County Title Co.	Ardmore, Okla.	Prep. of Abstract	17.75
Preston Dawson	Ardmore, Okla.	Prep. of Abstract	16.00
Cortez Craddock	Ardmore, Okla.	Labor	17.50
Jeff Craddock	Ardmore, Oklahoma	Labor & Com.	245.00
Florine Henderson	Wilson, Oklahoma	Cash loan	50.00
R. L. Davis	Wilson, Oklahoma	Com.	75.00
Ollie Anderton	Ardmore, Oklahoma	Labor	150.00
Dr. Walter Johnson	Ardmore, Oklahoma	Medical Services	56.00
W. W. Potter	Ardmore, Oklahoma	Exam. of Abstract	17.50
Cain Miller	Tussy, Oklahoma	Labor for self & team	80.00
Bill F. Womack	Tussy, Oklahoma	Labor	38.00
C. F. Stinnett	County Line, Okla.	"	12.00
Ben Sutton	Tussy, Oklahoma	"	27.00
W. E. Lambert	Ardmore, Okla.	"	14.50
Paul Newman	Healdton, Okla.	"	35.00
Bill Newman	Healdton, Okla.	"	28.00

Name of Claimant	Address	Nature of Claim	Amount
A. D. Davis	Wilson, Okla.	Note	9,000.00
Ben Darling	Pauls Valley, Okla.	Labor	23.40
R. G. Shrader	Healdton, Oklahoma	"	20.00
W. W. Shrader	Healdton, Oklahoma	"	15.00
H. B. Shrader	Healdton, Oklahoma	"	20.00
H. W. Welch	Ardmore, Oklahoma	Labor on Farm	150.00
			[20]
29. Ida Belle Woodruff	Ardmore, Oklahoma	Borrowed money	59,872.09
30. Herman Woodruff	Pauls Valley, Okla.	Labor	14,000.00
31. Willie Mae Woodruff	Los Angeles, Cal.	Money Due	428,000,00
32. Howard Woodruff	" " "	" "	70,000.00
33. Margaret Woodruff	" " "	" "	80,000.00
34. Leonard J. Woodruff, Jr.	" " "	" "	50,000.00
35. M. E. Heiser	" " "	Judgment	278,631.71
36. Oregon State School Land Bank	Salem, Oregon	Borrowed money	25,385.00
37. Klamath Marsh	Klamath Falls, Oregon	" "	1,000.00
38. Federal Land Bank	Wichita, Kansas	" "	2,875.00
39. Ida Bell Woodruff	Ardmore, Oklahoma	" "	93,000.00
40. Taxes due United States, Oklahoma, Oregon, California & Iowa			30,365.00

Explanation of Debts:

None of the labor claimants now employed by bankrupt except Howard Woodruff.

None of the claims secured except as follows: Nos. 36, 37, 38, and 39, secured by real estate mortgages on property located in California, Oregon and Oklahoma.

No. 35 based on judgment rendered in the United States District Court Southern District of California, which bankrupt contends is void, without merit and should be set aside.

The exact amount of bankrupt's debts in most instances are not known to him and the amount of the debts indicated is subject to correction upon ascertainment of proper amount. [21]

"EXHIBIT C"

In the District Court of the United States for the Eastern District of Oklahoma.

In Bankruptcy No. 7623

In the Matter of LEONARD J. WOODRUFF, Bankrupt.

APPLICATION FOR ORDER UNDER GENERAL ORDER NO. 6

To the Honorable Judge of the District Court of the United States for the Eastern District of Oklahoma:

Your petitioner, Leonard J. Woodruff, the bankrupt herein, respectfully represents and shows as follows, to-wit:

I.

That he filed his petition in voluntary bankruptcy herein on the 5th day of July, 1939, and was adjudicated a bankrupt on the same day, and on the same day an order of reference was made herein referring the same to the Honorable George F. Clark, referee in bankruptcy.

II.

On the 5th day of July, 1939, the Honorable George F. Clark, referee in bankruptcy, gave notice to the bankrupt's creditors that the first meeting of creditors would be held at Ardmore, Oklahoma, on July 20, 1939, at 10 o'clock A. M., and the first meeting of creditors was held at the time and place appointed by the referee at which meeting P. M. Jackson of Ardmore, Oklahoma, was elected trustee and has qualified as such.

III.

On the 13th day of July, 1939, M. E. Heiser filed in the district court of the United States Southern District of California, central division, his creditor's petition in bankruptcy in which he alleges that this bankrupt is a resident of and has his principal place of business in the City of Los Angeles, Los Angeles County, within the Southern District of the State of California, and in which he asks that

that court adjudicate the bankrupt herein a bankrupt and administer upon his estate as such. A copy of which petition is hereto attached, marked "Exhibit A" and made a part hereof.

IV.

Bankrupt has filed an answer to said creditor's petition in bankruptcy so filed in the district court of the United States for the Southern District of California, central division, a copy of which answer is hereto attached, marked "Exhibit B" and made a part hereof.

V.

Bankrupt says that he has approximately 100 different tracts of land located within the jurisdiction of this court, that most of the records, books and papers pertaining to bankrupt's property are located within the jurisdiction of this court and that a large majority of bankrupt's creditors live within the jurisdiction of this court and that this court is the court which can administer upon his estate with the greatest convenience to the parties interested therein.

Wherefore, bankrupt prays the court for an order under general order No. 6, determining this court to be the court which can administer upon his [22] estate with the greatest convenience to the parties interested therein.

Wherefore, bankrupt prays the court for an order under general order No. 6, determining this

court to be the court which can administer upon his estate with the greatest convenience to the parties interested and that upon the entry of such order the proceedings filed by the petitioner M. E. Heiser in the district court of the United States for the Southern District of California, central division, be ordered dismissed or be ordered transferred to this jurisdiction.

LEONARD J. WOODRUFF,
Petitioner in Bankruptcy.

CHAMPION, CHAMPION & FISCHL,
Attorneys for Bankrupt.

State of Oklahoma
County of Carter
Eastern District of Oklahoma

I, Leonard J. Woodruff, the petitioner named in the foregoing application, do hereby make solemn oath that the statements therein are true, according to my knowledge, information and belief.

LEONARD J. WOODRUFF.

Subscribed and sworn to before me this the 25th day of July, 1939.

[Seal] J. WILLIAM CARNES,
Notary Public,
Ardmore, Okla.

My Commission Expires: Feby. 26, 1943.

[Endorsed]: Filed Aug. 9, 1939. [23]

[Title of District Court and Cause.]

PETITION FOR INSTRUCTIONS BY RECEIVER E. A. LYNCH, PETITION FOR AN ORDER TO IMPOUND.

To the Honorable Judges of the District Court of the United States, Southern District of California, Central Division:

Comes now E. A. Lynch, as receiver of the estate of Leonard J. Woodruff, a bankrupt, and respectfully shows to the Court:

1. That your petitioner, E. A. Lynch, is the duly appointed, qualified and acting receiver of the estate of Leonard J. Woodruff in the Southern District of California, having been appointed by an order of this court dated July 14, 1939.

2. That as receiver your petitioner has taken into actual possession, and his in possession of, a store building situated at the juncture of Hollywood Boulevard and Sunset Boulevard, which your petitioner alleges he was informed was purchased by the bankrupt at the cost of approximately $225,000.00. That your petitioner as such has taken possession of the stock in trade of merchandise in four stores located in said building known as Woodruff Antique Stores, consisting of, first, general stock of antiques, reproductions and imitations, pictures, prints, coppers, etc.; second, a stock of Oriental goods; third, a stock of Indian goods and Indian baskets, saddles, etc.; fourth, stock of firearms and a collection of medieval arms and objects of warfare.

There is in existence no inventory of said stock, which are very extensive. That there is no memorandum or books from which it can be ascertained what the cost of said merchandise was, or of its present value. The property was not insured at the time of bankruptcy and your petitioner has been uncertain as to the amount of [24] insurance to be placed thereon, but has covered it for fire loss purposes at the present time in the amount of $..... That your petitioner has no inventory and so notified the insurance companies carrying said fire loss insurance policies.

That your petitioner has heretofore petitioned this court for authority to instruct one of his counsel to examine the bankrupt concerning the nature, extent and value of the properties reduced to possession by your receiver, and pursuant to an order made by this court in that behalf your receiver has caused Rupert B. Turnbull, one of his counsel, to proceed to Ardmore, Oklahoma, for the examination for the purpose of obtaining information from the bankrupt by examination to be conducted before the referee in bankruptcy, the Honorable George F. Clark. That a bankruptcy proceeding is pending in the Eastern District of Oklahoma relating to the same bankrupt herein, Leonard J. Woodruff, and the matter has been referred, both specially and generally, as referee and special master, to the Honorable George F. Clark, sitting at Ardmore, Carter County, Oklahoma. That Rupert B. Turnbull, did proceed to Ardmore, Oklahoma,

and appeared on behalf of your receiver and one of his attorneys, before the Honorable George F. Clark, referee in bankruptcy, sitting in the District Courtroom in the Federal Building, at Ardmore, Oklahoma, on Friday, the 11th day of August, 1939. That at said time, the said bankrupt, Leonard J. Woodruff, was present. Said Rupert B. Turnbull having theretofore communicated with the said referee in bankruptcy requested the production of the bankrupt at such time. That at such time and upon the calling of the Court at 1:30 P. M. on the 11th day of August, 1939, substantially, but not verbatim, the following occurred:

By Mr. Turnbull: May I proceed?

By the Court: Yes.

By Mr. Turnbull: My name is Rupert B. Turnbull and I represent to the Court at this time that there is pending in the Southern District [25] of California, in the District Court at that place, an involuntary proceeding against Leonard J. Woodruff. In that proceeding the Court has made its order appointing E. A. Lynch as receiver. In support of that statement I hand your Honor herewith a certified copy of the order appointing E. A. Lynch as receiver. (Thereupon there was handed to the Court a certified copy of the order made by this court appointing E. A. Lynch receiver). I represent to your Honor that I am one of the attorneys employed by that receiver, E. A. Lynch, pursuant to an order of that court. I hand you herewith in support of that statement a copy of the

order of the District Court of Southern District of California, authorizing such employment. I represent to your Honor that I now appear as the attorney for said receiver, E. A. Lynch, and pursuant to an order of the District Court of the Southern District of California authorizing E. A. Lynch to instruct me to appear here and examine Leonard Woodruff concerning the nature, extent and value of the property in the Southern District of California, and for the purpose of properly preserving, inventorying and insuring that property adequately, I ask the privilege of examining the said Leonard Woodruff at this time for the limited purpose as I have stated.

That at said time Leonard Woodruff was in the courtroom available for such examination. That at such time he was represented by his counsel, Champion, Champion, and Fischel. That Louis Fischel arose and addressed the Court on behalf of the bankrupt and stated to the Court that the receiver in the California Court was an interloper, had no rights before the Oklahoma Courts, and that this, the District Court for Eastern Oklahoma, should refuse him any rights of examination of the bankrupt for any purposes. Thereupon Rupert B. Turnbull, acting as attorney for E. A. Lynch, stated to the Court, truthfully, that the receiver in California was in a very uncomfortable position in that he had been ordered by the District Court in Southern California to merger, preserve and insure [26] the property. That he

thought he was entitled to the aid of the bankrupt and the knowledge of the bankrupt concerning the nature, extent and value of these antiques and other collections, and also with respect to other property which had been located by the receiver, which property belonged to the bankrupt, which is not inventoried in the bankrupt schedules as filed in the District Court in the Eastern District of Oklahoma. Thereupon the court sustained the objection of counsel for bankrupt and refused permission to *Ruperty* B. Turnbull, acting as attorney for the receiver, E. A. Lynch, to examine the bankrupt, Leonard J. Woodruff, notwithstanding that he was personally present at the Court at the said time.

Your petitioner is informed by his counsel, Rupert B. Turnbull, who is also counsel for petitioning creditor and another creditor herein, that during the examination of the bankrupt at Ardmore, Oklahoma, on the 11th and 12th days of August, 1939, Leonard Woodruff was called as a witness in a proceeding challenging the jurisdiction of the Eastern District of Oklahoma to administer the estate of bankrupt, which proceeding was instituted by M. E. Heiser, a judgment creditor having a provable claim in the form of a final judgment of this court against the bankrupt in the sum of $278,663.21 and joined in by George F. Fowler, a creditor having a provable claim of $31,000.00. That the said Leonard J. Woodruff under oath testified that he had purchased the building housing

Woodruff Antique Stores of Los Angeles, California at a cost of $225,000.00, and that there was in the basement of the home of the bankrupt's wife where the bankrupt has been living for several years last past at 2446 Inverness Avenue, Los Angeles, California, a collection of archeological antiques dug from Panama ruins, and other antiques which had previously been in the store on Hollywood Boulevard, to-wit: Woodruff Antique Stores, which collections and antiques were of the value of approximately $50,000.00. Your petitioner alleges that the building in which said basement occurred is claimed to be owned by [27] the wife of Leonard J. Woodruff but that said stock is part of the stock of bankrupt's stores. Your petitioner trustee, as receiver, desires an order authorizing him to take possession of said antiques stored in the basement in the house at 2446 Inverness Avenue, and an order from this Court authorizing the United States Marshal to give to your receiver *suck* aid as may be necessary to remove from said basement of said house the said antiques.

Your petitioner alleges that all of the family of the bankrupt have removed from 2446 Inverness Avenue, and are now at Ardmore, Oklahoma, and that the said residence in Los Angeles is in the sole possession and custody of a Chinese cook named Wong.

Your petitioner, as receiver, requests instructions of this Court as to the extent to which he shall expend funds for the inventorying, preserv-

ing and insuring the antiques in the store on Hollywood Boulevard and Sunset Boulevard, as well as those in the basement in the home at 2446 Inverness. Your petitioner alleges that the stock is so extensive that your petitioner recommends that for the purpose of inventorying, it be divided into three classes; first, the class of antiques and collections of the greatest value; second, a medium-priced class of goods and antiques and imitations and reproductions of lesser value within prescribed limitation of maximum and minimum value; and third, a class of miscellaneous prints, secondhand and junk material.

Wherefore, your petitioner, as receiver, prays that the Court give him instructions as to a conduct in the above entitled matters, and issue its Orders in that regard for the marshaling, protection, preservation, and insuring of such and other properties within this jurisdiction.

(Signed) E. A. LYNCH,
E. A. Lynch, as Receiver of the Estate of Leonard Woodruff, a Bankrupt.

RUPERT B. TURNBULL,
LEONARD MEYBERG,
Attorneys for Receiver. [28]

State of California,
County of Los Angeles—ss.

E. A. Lynch being by me first duly sworn, deposes and says that he is the petitioner in the above en-

titled action; that he has heard read the foregoing petition and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon information or belief, and as to those matters that he believes it to be true.

E. A. LYNCH.

Subscribed and sworn to before me this 17th day of August, 1939.

[Notarial Seal]

GEORGE A. JUDSON,

Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed Aug. 17, 1939. [29]

[Title of District Court and Cause.]

ORDER MADE UPON RECEIVER'S PETITION FOR INSTRUCTIONS AND ORDER FOR SEIZURE AND IMPOUNDING OF CERTAIN PROPERTY.

The verified petition of the receiver, E. A. Lynch, to the Court that there is pending not only in this District a petition in bankruptcy against Leonard J. Woodruff, but there is also pending a petition by the bankrupt in the Eastern District of Oklahoma, all of which facts were originally disclosed to this Court upon the filing of the original creditors' petition herein, and it appearing that the question of jurisdiction as to which District Court is to

handle the primary estate of the bankrupt is a question which has not yet been decided, a portion of said jurisdictional question being now pending and undecided in the Eastern District of Oklahoma, and it appearing that this Court has heretofore directed the receiver, E. A. Lynch, to marshal, impound and insure the property in the Southern District of California;

Now Therefore It Is Hereby Ordered that the receiver herein, E. A. Lynch, having the marshaling, care and insurance protection of the assets of the debtor in Southern California, proceed forthwith to inventory the extensive stock of antiques, second hand goods, Indian and Oriental goods, arms collections, paintings, and archaeological exhibits, now situated in the stores known as the "Woodruff Antique Stores," at Los Angeles, California, now in the possession of the receiver, and also to inventory the antiques in the basement of the residence at 2442 Inverness Avenue, Los Angeles, in the following manner:

To inventory and appraise as Class A the more expensive and valuable art objects, oriental, Indian and archaeological goods, [30] and arms collections, etc;

To inventory and appraise as Class B the medium or lesser priced articles; and,

In the lower or third class, second hand materials, junk, and miscellaneous articles, to inventory and appraise, if necessary, only by lots or groups

without the necessity of individually writing up and appraising each of the lesser groups.

It Is Further Ordered upon ascertaining the value of such property, said receiver, if necessary, cover any additional valuation shown by inventory and appraisement by adequate fire insurance on the building housing said antiques on Hollywood and Sunset Boulevards, in Los Angeles, forthwith.

It Is Further Ordered that said Receiver, E. A. Lynch, take into his possession and impound the antiques and archaeological collections which may now be in the basement of the residence at 2442 Inverness Avenue, and for the purpose of taking possession thereof, it appearing that the said residence is now unoccupied but is in charge of a Chinese cook known as "Wong", that the United States *Marchal* of this District give such aid as may be necessary to place the receiver in possession of such property and permit the said receiver to remove the same to a fireproof warehouse segregated from any other assets of the bankrupt so that the same may be inventoried and appraised and impounded.

Dated August 17th, 1939, at 11 A. M.

(Signed) PAUL J. McCORMICK,
United States District Judge.

[Endorsed]: Filed Aug. 17, 1939. [31]

Department of Justice, United States District Court, Office of the Clerk, Eastern District of Oklahoma.

Muskogee, Oklahoma, October 16, 1939.

Hon. R. S. Zimmerman,
Clerk U. S. District Court,
Southern District of California.

In re: In the Matter of Leonard J. Woodruff, No. 7623 in Bkr., Bankrupt.

Dear Sir:

Enclosed herewith is Duplicate Original Order under General Order No. 6 in the above styled and numbered cause in this court, for your files in the your No. 34521 J in Bankruptcy.

This order has no certification thereto attached for the reason that it is a duplicate original and bears the genuine signature of this Court.

Respectfully,
W. V. McCLURE,
By MAGGIE JO DAGLEY,
Deputy.

Encl. 1/1-O. [32]

In the United States District Court for the Eastern District of Oklahoma.

In Bankruptcy No. 7623.

In the Matter of LEONARD J. WOODRUFF, Bankrupt.

(Filed Oct. 16, 1939—W. V. McClure, Clerk U. S. District Court.)

Now, on this the 16th day of October, 1939, this matter comes on for hearing before the undersigned District Judge at Muskogee, Oklahoma, after due, reasonable and proper notice to all interested parties, upon the application of bankrupt and of the creditors C. F. Dillars, et al, for an order under general order No. 6, finding that this court can proceed with the administration of the bankrupt's estate with the greatest convenience to the parties interested. The bankrupt appearing in person and by his attorney, Thos. W. Champion, and the creditors, C. F. Dillard, et al, appearing by their attorney, W. W. Potter, and the trustee, P. M. Jackson, appearing in person, and no other appearances being made either in person or by counsel. Thereupon the Court proceeded to hear said application and the evidence in support thereof, and having heard the same and being advised in the premises, the court finds that the Eastern District of Oklahoma is the domicile of the bankrupt and that the bankrupt intends to continue making said district his domicile, that a large part of the property of the bankrupt is located in said District; that the

available records, books and papers with respect to bankrupt's business are located in said District; that the majority of the creditors in number both secured and unsecured, reside in said District, and that creditors holding claims in considerable amounts reside in said District; that the bankrupt has 80 or 90 different tracts of land in said District which require the attention of the trustee in renting, managing and in collecting the rents therefrom, and other property therein; that this District was the domicile and principal place of business of the bankrupt for the greater part of the six months immediately *proceed*ing the filing of the petition in bankruptcy herein, and that this is the court which can proceed with the administration of bankrupt's estate with the greatest convenience to the parties interested in said estate.

The Court further finds that on the 13th day of July, 1939, M. E. Heiser, one of the creditors of bankrupt, filed an involuntary petition in bankruptcy in the United States District Court for the Southern District of California, Central Division, being cause No. 34521-J in Bankrupt therein and that E. A. Lynch was appointed receiver in said action and is now acting as such receiver; that said proceeding should be transferred to this Court and this judicial district and should be consolidated with this case and that the trustee should take *cahrge* of all of the property of the bankrupt including that located in California.

It Is Therefore Ordered, Adjudged and Decreed that the United States District Court for the Eastern District of Oklahoma is the bankruptcy court which can proceed with the administration of bankrupt's estate with the greatest convenience to the parties interested therein. [33]

It Is Further Ordered, Adjudged and Decreed that cause No. 34521-J in bankruptcy, being in the matter of Leonard J. Woodruff bankrupt, in the United States District Court, Southern District of California, Central Division, be and the same is hereby ordered transferred to this court and consolidated with this cause.

It Is Further Ordered, Adjudged and Decreed that the trustee herein immediately assume and take charge of all of the property of the bankrupt wherever located and that the possession of such trustee be exclusive until otherwise ordered by this court.

(Signed) EUGENE RICE,
District Judge.

[Endorsed]: Filed Oct. 16, 1939. W. V. McClure, Clerk, U. S. District Court.

[Endorsed]: Filed Oct. 18, 1939. [34]

In the District Court of the United States, Southern District of California, Central Division.

In Bankruptcy No. 34521-J.

In the Matter of

LEONARD J. WOODRUFF,

Bankrupt.

ORDER DIRECTING CLERK TO STAY TRANSMISSION OF RECORDS TO CLERK OF EASTERN DISTRICT OF OKLAHOMA UNTIL THE DETERMINATION OF COSTS OF ADMINISTRATION IN THIS JURISDICTION: ORDER REQUIRING RECEIVER TO FILE HIS REPORT AND ACCOUNT AND PETITION FOR COMPENSATION, AND REQUIRING ATTORNEYS FOR THE RECEIVER TO FILE THEIR PETITION FOR COMPENSATION HEREIN

It appearing to this Court by the filing in the office of the Clerk thereof, at Los Angeles, California, of copy of an order made October 16, 1939, by the Honorable Eugene Rice, one of the Judges of the District Court of the United States for the Eastern District of Oklahoma in the Matter of Leonard J. Woodruff, Bankrupt, Numbered 7623 in said Court for the Eastern District of Oklahoma, that the said Court has made an order purporting to be made under General Order No. 6, and it appearing further that the basis for making of said order by the said District Court for the

Eastern District of Oklahoma is either the finding or the assumption on the part of said Court that the District Court of the United States for the Southern District of California, to-wit this Court, has jurisdiction as well as the District Court for the Eastern District of Oklahoma with respect to the bankruptcy proceedings of Leonard J. Woodruff, Bankrupt; and it further appearing to this Court from its records in this cause that this Court has heretofore appointed a Receiver herein, E. A. Lynch, at a time when it was absolutely necessary for a Receiver to take charge of and marshal, preserve and [35] recover and care for the assets of Leonard J. Woodruff, and that said Receiver has obtained instructions from this Court concerning his conduct as well as has received suggestions from P. M. Jackson, Trustee in Bankruptcy in the matter of the estate of Leonard J. Woodruff, Bankrupt, as well as has had suggestions in respect to his duties concerning the taking of an inventory and making an appraisement from the Honorable George F. Clark, one of the Referees in Bankruptcy in the District Court for the Eastern District of Oklahoma, to whom the proceeding in said Oklahoma court in the matter of Leonard J. Woodruff bankruptcy has been generally *refered* for administration; and it further appearing to this Court that the Court has made its order authorizing the employment of counsel for the Receiver, who have rendered services for the benefit of the estate and for the benefit of the creditors; and the

said Receiver having not yet filed his report and account, nor a statement of his expenses, nor having been discharged, nor having had his compensation fixed, allowed or paid, and there having been no opportunity yet for the filing of such report, Now Therefore,

It Is Hereby Ordered that the Clerk of the District Court of the United States for the Southern District of California, Central Division, stay the transmittal of the records in this proceeding as the same exist in this jurisdiction until such time as this Court shall have made its further orders approving, or disapproving, the report and account filed by the Receiver as appointed by this Court, and shall have made the allowance to the Receiver and to his attorneys for compensation and for expenses, and shall have made an order with respect to the payment thereof;

It Is Further Ordered that the Receiver appointed by this Court, E. A. Lynch, prepare and file within five days from date of this order his report and account, and petition for compensation, as Receiver herein, and within the same time that the attorneys [36] for the Receiver employed under order of this Court prepare and file their report and petition for compensation;

It Is Further Ordered that thereupon the Clerk of this Court, upon receipt of said petition and report, place the matter on the calendar of this Court for the first possible date, after causing to be given at least ten days notice of the date of such

hearing, and of the filing of such report and account and petitions, to the following interested parties, to wit:

(a) The bankrupt, Leonard J. Woodruff, c/o Mr. Hiram T. Casey, his attorney, Rowan Building, Los Angeles, California;

(b) To the bankrupt, Leonard J. Woodruff, c/o his attorneys in Oklahoma, Messrs. Champion, Champion & Fischl, Ardmore, Oklahoma;

(c) To the Trustee in Bankruptcy appointed by the Eastern District of Oklahoma court, Mr. P. M. Jackson, Trustee, Ardmore, Oklahoma;

(d) To each of the persons who are listed as his creditors in the Answer of Leonard J. Woodruff filed in these proceedings in this Court, including the petitioning creditor M. E. Heiser;

(e) To the Honorable George F. Clark, Referee in Bankruptcy, District Court of the United States for the Eastern District of Oklahoma, McAllister, Oklahoma.

Dated: October 19th, 1939.

GEORGE COSGRAVE,
Judge of United States District Court for the Southern ern District of California, Central Division.

[Endorsed]: Filed Oct. 19, 1939. [37]

In the District Court of the United States for the Eastern District of Oklahoma.

In Bankruptcy. No. 7623.

In the Matter of LEONARD J. WOODRUFF, Bankrupt.

ORDER APPOINTING ATTORNEY FOR TRUSTEE

Upon consideration of the verified application of P. M. Jackson, Trustee in Bankruptcy herein, for authority to employ Francis B. Cobb, attorney of Los Angeles, California, to represent said Trustee in the matter of the application of E. A. Lynch for compensation and expenses as Receiver and for compensation of said Receiver's attorneys, which application is pending in the District Court of the United States for the Southern District of California, Central Division; and it appearing from said application that said attorney, Francis B. Cobb, represents no interest adverse to the Receiver, the Trustee or the estate in the matter upon which he is to be engaged; and that his employment would be to the best interest of the estate,

It Is Ordered that the Trustee be, and he is hereby, authorized to employ the said Francis B. Cobb as his attorney to represent the Trustee in the matter of the application of the said E. A. Lynch for compensation and expenses for himself and his attorneys, as aforesaid.

Dated at McAlester, said District, this the 30th day of October, 1939.

GEO. F. CLARK,
Referee in Bankruptcy.

[Endorsed]: Filed Oct. 30, 1939. Geo. F. Clark, Referee. [38]

United States of America
Eastern District of Oklahoma—ss.

I, Geo. F. Clark, Referee in Bankruptcy at McAlester, said Eastern District of Oklahoma, do hereby certify the foregoing to be a true, full and correct copy of Order Appointing Attorney for Trustee, in re Leonard J. Woodruff, Bankrupt, Cause No. 7623 now on file in my office.

Witness my hand at McAlester, said District, this October 30, 1939.

GEO. F. CLARK,
Referee in Bankruptcy.

[Endorsed]: Filed Nov. 2, 1939. [39]

[Title of District Court and Cause.]

MOTION TO VACATE EX PARTE ORDER OF OCTOBER 19, 1939, STAYING TRANSMITTAL OF RECORDS.

To E. A. Lynch, Receiver in the Above Entitled Proceeding, and to His Attorneys of Record, Rupert B. Turnbull and Leonard J. Meyberg:

You, and each of you, will please take notice that on the 6th day of November, 1939, at the hour of

10 o'clock A. M., or as soon thereafter as counsel may be heard, P. M. Jackson, as Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a Bankrupt, in case numbered 7623 now pending in the District Court of the United States for the Eastern District of Oklahoma, through his attorney of record, Francis B. Cobb, will make a motion before the Honorable Geo. Cosgrave, Judge of the above entitled court, at Room 1, Federal Building, Los Angeles, California, for an order setting aside and vacating that certain order entered on the 19th day of October, 1939, staying transmittal of records in this proceeding, and all proceedings taken thereunder, upon the ground that a voluntary petition in bankruptcy was filed by Leonard J. Woodruff in the District Court of the United States for the Eastern District of Oklahoma on the 5th day of July, 1939, and thereafter on or about the 13th day of July, 1939 the above entitled proceeding was filed, and that thereafter on October 16th, 1939 a proceeding was had under General Order No. 6 before the District Court of the United States for the Eastern District of Oklahoma, after which proceeding an order was entered determining that the said Eastern District of Oklahoma could proceed with the greatest convenience to all parties in interest and that all future proceedings should be had before said court, and direct- [40] ing the clerk of said court to transmit a copy of said order to the clerk of this court, reference to said copy

being hereby made for more particulars. That by reason of said proceeding had under General Order No. 6 and said order of October 16th, 1939, the order made by this court ex parte on October 19th, 1939 was in violation of the General Orders in Bankruptcy, and the Bankruptcy Act as amended, and the rules of this court, and that the same is void and of no force and effect, and that the above entitled court has no jurisdiction to act in any further proceedings in the above entitled matter, but only has jurisdiction to transmit the records of the proceeding herein to the District Court of the United States for the Eastern District of Oklahoma.

You are further notified that said motion will be made upon the copy of the order of the District Court of the United States for the Eastern District of Oklahoma filed in the files in the above entitled proceeding on October 18th, 1939, and upon the files and records of the proceedings herein.

Dated this 2nd day of November, 1939.

FRANCIS B. COBB,

Attorney for P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, in case No. 7623 now pending in the District Court of the United States for the Eastern District of Oklahoma.

639 So. Spring St., Los Angeles, Calif.

Points and Authorities:

General Order No. 6;

Section 32 of the Bankruptcy Act;

Rules of Civil Procedure, Rule 7, Subdivision (b).

In re So. States Finance Co. 19 Fed. (2d) 959.

Gross vs. Irving Trust, 289 U. S. 342.

Good cause appearing, the time for the service of the within motion is hereby shortened so that the same may be served on or before November 2nd, 1939.

Nov. 2, 1939.

GEO. COSGRAVE,
Judge.

[Endorsed]: Filed Nov. 2, 1939. [41]

In the District Court of the United States, Southern District of California, Central Division.

No. 34521-J. Bkcy.

In the Matter of
LEONARD J. WOODRUFF,
Alleged Bankrupt.

MEMORANDUM OF ORDER.

Cosgrave, District Judge.

Leonard J. Woodruff was adjudicated a bankrupt on his voluntary petition therefor in the Eastern

District of Oklahoma on July 5, 1939, and P. M. Jackson since has been appointed trustee of the bankrupt estate. On July 13, 1939 an involuntary petition seeking the adjudication of Leonard J. Woodruff as a bankrupt was filed in the Southern District of California. On petition setting up legal necessity therefor, E. A. Lynch was appointed receiver under the involuntary petition by the California court, and authorized to employ counsel. A considerable amount of real, as well as personal property, the latter being an extensive store for the sale and rental of antiques, was located in California, and the receiver was authorized to operate this business.

On October 16, 1939, the court in Oklahoma, acting under General Order in Bankruptcy No. 6, after application therefor and hearing on such application, found the Eastern District of Oklahoma to be the domicile of the bankrupt during the required period, and also found it to be the principal place of business of the bankrupt, and because of these and other entirely sufficient reasons, that court found that it is the court which can proceed with the administration of the bankrupt's estate with the greatest convenience to the parties interested. The court then by its decree adjudged accordingly, and by its order transferred the case pending in the Southern District of California to the Eastern District of Oklahoma, and consolidated it with the case pending in the last named district.

Mr. Lynch, the receiver in California, does not question [42] the effectiveness of the decision of the Oklahoma court, since it was the first to acquire jurisdiction, but he insists that this court must settle his account as receiver before the case is transferred. Immediately after the filing in the office of the Clerk of this court of a certified copy of the decree of the Oklahoma court, Mr. Lynch procured an ex parte order delaying the execution of the decree of the Oklahoma court until his said account is settled. Mr. Jackson, trustee in the Oklahoma proceeding, now moves this court to set aside its order staying the transfer of the case, and instead to order such transfer forthwith. The question presented, therefore, is whether this court has jurisdiction and duty to settle the account of the California receiver before the case is transferred to the Eastern District of Oklahoma.

The involuntary petition filed in California alleges that the residence, domicile, and principal place of business of the bankrupt is in this district. The Oklahoma court finds that the domicile and principal place of business of the bankrupt is in the Eastern District of Oklahoma.

It is plain that the California court is not without jurisdiction in the premises. The District Court may:

> "adjudge persons bankrupt who have had their principal place of business, resided or had their domicile within their (the court's) respective

> territorial jurisdiction for the preceding six months." Bankruptcy Act 2, a (1).

In fact, the order of the Oklahoma court presumes this to be the case for that order is based on General Order No. 6:

> "If two or more petitions are filed by or against the same person * * * in different courts, EACH OF WHICH HAS JURISDICTION * * * etc."

which General Order is itself based on Section 32 of the Bankruptcy Act (11 U. S. C. 55):

> "In the event petitions are filed by or against the same person * * * in different courts of bankruptcy, EACH OF WHICH HAS JURISDICTION, the case shall, by order of the court first acquiring jurisdiction, be transferred to and consolidated [43] in the court which can proceed with the same for the greatest convenience of parties in interest."

It was a matter of uncertainty at the time that the involuntary petition was filed in California in which jurisdiction the administration of the estate finally would be had.

It is true that the California proceeding is not ancillary to that in Oklahoma, (Bankruptcy Act, 2, a (20), 69, c, General Order 51) within the meaning of the Bankruptcy Act.

The action here invoked by the California receiver is not in the administration of the bankrupt

estate as such. It must be assumed that on the showing made in his petition this court exercised a sound discretion in the appointment of a receiver. Plainly, it was a part of prudence to insure the property and keep it intact. A duty is imposed on every court, having property in its possession, to preserve the same and to control and to compensate its own officers in the performance of their duties with respect to such property.

The motion of Mr. Jackson must be denied, and it is so ordered.

November 15, 1939.

[Endorsed]: Filed Nov. 15, 1939. [44]

At a stated term, to wit: The September Term, A. D. 1939, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Wednesday the 15th day of November in the year of our Lord one thousand nine hundred and thirty-nine.

Present:

The Honorable: Geo. Cosgrave, District Judge.

No. 34,521-J Bkcy

In the Matter of
LEONARD J. WOODRUFF,
Alleged Bankrupt.

This matter having come before the Court on November 8, 1939, for hearing on motion of P. M. Jackson, as Trustee for the Estate of Leonard J. Woodruff, Bankrupt, in case No. 7623 now pending in District Court of United States for Eastern District of Oklahoma, to vacate ex parte order of October 19, 1939, staying transmittal of records, pursuant to motion filed November 2, 1939, and having been argued and submitted on briefs on file forthwith, and having been duly considered by the Court, the Court now files its "Memorandum of Order", and pursuant thereto, the motion of Mr. Jackson is denied. [45]

[Title of District Court and Cause.]

PETITION FOR APPEAL

To the Honorable Geo. Cosgrave, District Judge:

P. M. Jackson, Trustee in Bankruptcy for Leonard J. Woodruff, a bankrupt, feeling aggrieved by an Order entered in the above entitled matter on October 19th, 1939, entitled "Order Directing Clerk to Stay Transmission of Records to the Clerk of the Eastern District of Oklahoma Until the Determination of Costs of Administration in This Jurisdiction, Order Requiring Receiver to File His Report and Account and Petition for Compensation, and Requiring Attorneys for the Receiver to File Their Petition for Compensation", and a Memoran-

dum of Order and Minute Order entered in the above entitled matter on November 15th, 1939, denying the trustee's motion to vacate and set aside said previous order of October 19th, 1939, does hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit from said orders and each of them and from the whole and each part thereof, for the reasons set forth in the assignment of errors filed herewith, and prays that his appeal be allowed, and that a citation in accordance with law be issued, and that the record and documents on which said proceedings and orders were based, duly authenticated, may be sent to said Circuit Court of the United States for the Ninth Circuit under the rules of said court, in such cases provided.

FRANCIS B. COBB
Attorney for Petitioner and Appellant

[Endorsed]: Filed Nov. 17, 1939. [46]

[Title of District Court and Cause.]

ASSIGNMENT OF ERRORS

Now comes P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a Bankrupt, and files the following assignment of errors upon which he will rely in his prosecution of the appeal in the above entitled matter from an Order entered on October 19th, 1939 and from a Memorandum of Order and Minute Order of November 15th, 1939.

I.

The Court erred in entering the Order of October 19th, 1939, after proceedings were had under Section 32 of the Bankruptcy Act and under General Order No. 6 in the District Court for the Eastern District of Oklahoma and said last mentioned court had determined that the best interests of all parties would be served by the administration of the estate of Leonard J. Woodruff in Oklahoma.

II.

The Court erred in attempting to exercise jurisdiction over the assets of this estate through its receiver, where Leonard J. Woodruff had been adjudicated a bankrupt in Oklahoma before the filing of the involuntary petition in the above entitled proceeding.

III.

The Court erred in ordering the receiver and his attorneys to file the reports and petitions for fees before the transmittal of the records of the proceedings herein to the District Court of Oklahoma.

[47]

IV.

The Court erred and exceeded its jurisdiction in restraining the Clerk of the District Court from transmitting the records of these proceedings to the District Court in Oklahoma.

V.

The Court erred in entering the order of October 19th, 1939, without notice to the attorney of record for the alleged bankrupt and the appellant herein.

VI.

The Court erred and exceeded its jurisdiction in proceeding to settle the receiver's report and the receiver's attorneys' fees.

VII.

The Court erred in denying the trustee's motion to vacate said order of October 19th, 1939, where said order was void and the court had lost jurisdiction, and said order was entered in violation of the Bankruptcy Act and the General Orders in Bankruptcy.

Wherefore the said appellant prays that the said orders of October 19th, 1939, and November 15th, 1939, be reversed and said District Court of the United States for the Southern District of California, Central Division, be ordered to forthwith transmit the records of the proceedings herein to the District Court of Oklahoma, and appellant be granted such relief and orders as may appear proper to the Circuit Court of Appeals for the Ninth Circuit.

FRANCIS B. COBB

Attorney for Appellant.

[Endorsed]: Filed Nov. 17, 1939. [48]

[Title of District Court and Cause.]

NOTICE OF APPEAL

To E. A. Lynch, Receiver in the Above Entitled Proceeding, and to His Attorneys of Record, Rupert B. Turnbull and Leonard J. Meyberg, and to the Honorable Geo. Cosgrave, Judge of the United States District Court:

P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt, feeling aggrieved by a decree and order entered on October 19th, 1939 and by a memorandum of order and minute order entered by the above entitled court on November 15th, 1939 denying the trustee's motion to vacate and set aside said previous order of October 19th, 1939, does hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit, pursuant to Sections 24 and 25 of the Bankruptcy Act as amended, and General Orders in Bankruptcy No. 36, from each of said orders and each portion thereof.

Your petitioner prays that the proper record on appeal, as provided under Rule 75 of the Federal Rules of Civil Procedure, be docketed in this appeal and be heard and determined as provided by law.

Dated this 17th day of November, 1939.

FRANCIS B. COBB

Attorney for Appellant.

Copy of above Notice mailed to Rupert B. Turnbull and Leonard J. Meyberg, Attys. for E. A. Lynch, receiver, Nov. 18, 1939.

R. S. ZIMMERMAN,
Clerk,

By E. L. S.
Deputy

[Endorsed]: Filed Nov. 17, 1939. [49]

[Title of District Court and Cause.]

ORDER ALLOWING APPEAL

Upon motion of Francis B. Cobb, attorney for P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

It Is Hereby Ordered that an appeal to the Circuit Court of the United States for the Ninth Circuit from an order entered by this court on the 19th day of October, 1939, and from a memorandum of order and minute order entered by this court on the 15th day of November, 1939, be and the same is hereby allowed, and a certified copy of the transcript of the record and all proceedings be forthwith transmitted to the Circuit Court of the United States for the Ninth Circuit.

It Is Further Ordered that pursuant to Section 25, subdivision b, of the Bankruptcy Act as amended, that P. M. Jackson, as trustee, shall not be required to give bond herein.

Dated this 17th day of November, 1939.

GEO. COSGRAVE

District Judge

[Endorsed]: Filed Nov. 17, 1939. [50]

[Title of District Court and Cause.]

APPELLANT'S STATEMENT OF THE POINTS ON WHICH HE INTENDS TO RELY ON THE APPEAL.

P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a Bankrupt, does hereby designate the points on which he intends to rely on the appeal in the above entitled matter, as follows:

I.

The Court erred in entering the order of October 19th, 1939, after proceedings were had under Section 32 of the Bankruptcy Act and under General Order No. 6 in the District Court for the Eastern District of Oklahoma and said last mentioned court had determined that the best interests of all parties would be served by the administration of the estate of Leonard J. Woodruff in Oklahoma.

II.

The Court erred in attempting to exercise jurisdiction over the assets of this estate through its receiver, where Leonard J. Woodruff had been adjudicated a bankrupt in Oklahoma before the filing

of the involuntary petition in the above entitled proceeding.

III.

The Court erred in ordering the receiver and his attorneys to file the reports and petitions for fees before the transmittal of the records of the proceedings herein to the District Court of Oklahoma.

IV.

The court erred and exceeded its jurisdiction in restrain- [51] ing the Clerk of the District Court from transmitting the records of the proceedings to the District Court of Oklahoma.

V.

The Court erred in entering the order of October 19th, 1939, without notice to the attorney of record for the alleged bankrupt and the appellant herein.

VI.

The Court erred and exceeded its jurisdiction in proceeding to settle the receiver's report and the receiver's attorneys' fees.

VII.

The Court erred in denying the trustee's motion to vacate said order of October 19th, 1939, where said order was void and the Court had lost jurisdiction, and said order was entered in violation of the Bankruptcy Act and the General Orders in Bankruptcy.

Dated this 17th day of November, 1939.

FRANCIS B. COBB

Attorney for Appellant

[Endorsed]: Filed Nov. 17, 1939. [52]

[Title of District Court and Cause.]

ORDER SETTLING AND DESIGNATING THE RECORD ON APPEAL.

P. M. Jackson, Trustee in Bankruptcy, having appealed from an order of this court on October 19th, 1939, and an order entered on November 15th, 1939, and having designated in writing certain records to be contained in the record on appeal, and E. A. Lynch, Receiver in the above entitled matter, having objected to the appellant's designation and having made counter designations, and P. M. Jackson, through his attorney Francis B. Cobb, having filed a written motion for this court to settle the differences between counsel and to designate the proper records and documents to constitute the proper record on appeal, and the matter having been argued by Francis B. Cobb, attorney for P. M. Jackson, and by Rupert B. Turnbull, attorney for E. A. Lynch, the court now enters the following order:

It Is Hereby Ordered that the following stipulated facts, documents, petitions and orders shall constitute the record on appeal to be certified by

the clerk of this court to the clerk of the United States Circuit Court of Appeals for the Ninth Circuit:

1. Creditors' Petition in Bankruptcy filed July 13, 1939.

2. Answer of Alleged Bankrupt filed August 9, 1939.

3. Order Under General Order No. 6 with letter attached, by the District Court for the Eastern District of Oklahoma filed October 18, 1939.

4. Order of October 19, 1939, en- [53] titled Order Directing Clerk to Stay Transmission of Records to the Clerk of the Eastern District of Oklahoma Until the Determination of Costs of Administration in This Jurisdiction, Order Requiring Receiver to File His Report and Account and Petition for Compensation, and Requiring Attorneys for the Receiver to File Their Petition for Compensation. Filed October 19, 1939.

5. Motion to Vacate Ex Parte Order of October 19, 1939, Staying Transmittal of Records. Filed November 2, 1939.

6. Order Appointing Attorney for Trustee. Filed November 2, 1939.

7. Memorandum of Order and Minute Order of November 15, 1939. Filed November 15, 1939.

8. Petition for Appeal and Notice of Appeal.

9. Order Allowing Appeal.

10. Assignment of Errors.

11. Appellant's Statement of the Points on Which he Intends to Rely on the Appeal.

12. Copy of this Order Settling and Designating the Record on Appeal.

13. Petition for the Appointment of the Receiver.

14. Order Appointing Receiver.

15. Petition by Receiver for Instructions.

16. Order of the Court Made on Receiver's Petition and Instructions. [54]

It Is Further Found That the following facts were stipulated to in open court on the date of the hearing of the motion of P. M. Jackson to vacate the order of October 19th, 1939, and said stipulations are ordered included in said record, said stipulated facts being:

1. That if Rupert B. Turnbull was called as a witness he would now testify that an appeal has been perfected from the order of Judge Eugene Rice of the District Court of the United States of the Eastern District of Oklahoma to the United States Circuit Court of Appeals for the Tenth Circuit, purporting to be made under General Order 6. That it be deemed that said Turnbull has been called and so testified, and that it was further stipulated that Leonard Woodruff, Bankrupt, petitioned voluntarily in the Eastern District of Oklahoma to be, and was, adjudicated on the sole ground that Woodruff had his principal place of business there.

2. That the petitioning creditor in the above entitled proceeding, M. E. Heiser, had actual

knowledge at the date of the filing of the involuntary proceeding herein that Leonard J. Woodruff had filed a voluntary petition in Oklahoma on July 5, 1939, and that an order of adjudication had been entered thereon on July 5, 1939, which fact was then orally communicated to the District Judge at Los Angeles, California.

Dated this 7th day of December, 1939.

GEO. COSGRAVE
District Judge

Approved as to form only.
RUPERT B. TURNBULL
Attorney for Receiver.

[Endorsed]: Filed Dec. 7, 1939. [55]

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

I, R. S. Zimmerman, Clerk of the District Court of the United States for the Southern District of California, do hereby certify the foregoing pages, numbered from 1 to 55, inclusive, contain original Citation and full, true and correct copies of Petition in Bankruptcy; Petition for appointment of a Receiver; Order appointing Receiver; Answer of Bankrupt; Petition for Instructions by Receiver, and Petition for Order to Impound; Order of Instructions for impounding; Order under General

Order No. 6; Order staying transmission of records; Order appointing attorney for trustee; Motion to vacate ex parte order of Oct. 19, 1939; Memorandum of Order; Order, Minute, of Nov. 15, 1939; Petition for Appeal; Assignments of Error; Notice of Appeal; Order Allowing Appeal; Appellant's Statement of Points, and Order Settling and Designating Record on Appeal, which constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I Do Further Certify that the fees of the Clerk for comparing, correcting and certifying the foregoing record amount to $9.05, and that said amount has been paid me by the Appellant herein.

Witness my hand and the Seal of the District Court of the United States for the Southern District of California, this 19th day of December, A. D. 1939.

[Seal] R. S. ZIMMERMAN,
Clerk
By EDMUND L. SMITH
Deputy Clerk.

[Endorsed]: No. 9401. United States Circuit Court of Appeals for the Ninth Circuit. P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt, Appellant, vs. E. A. Lynch, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt, Appellee. Transcript of Record. Upon Appeal from

the District Court of the United States for the Southern District of California, Central Division.

Filed December 21, 1939.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 9401

In the Matter of
LEONARD J. WOODRUFF,
Alleged Bankrupt.

APPELLANT'S STATEMENT OF THE POINTS ON WHICH HE INTENDS TO RELY ON THE APPEAL.

P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt, does hereby designate the points on which he intends to rely on the appeal in the above entitled matter, as follows:

I.

The Court erred in entering the order of October 19th, 1939, after proceedings were had under Section 32 of the Bankruptcy Act and under General Order No. 6 in the District Court for the Eastern District of Oklahoma and said last mentioned court

had determined that the best interests of all parties would be served by the administration of the estate of Leonard J. Woodruff in Oklahoma.

II.

The Court erred in attempting to exercise jurisdiction over the assets of this estate through its receiver, where Leonard J. Woodruff had been adjudicated a bankrupt in Oklahoma before the filing of the involuntary petition in the above entitled proceeding.

III.

The Court erred in ordering the receiver and his attorneys to file the reports and petitions for fees before the transmittal of the records of the proceedings herein to the District Court of Oklahoma.

IV.

The Court erred and exceeded its jurisdiction in restraining the Clerk of the District Court from transmitting the records of the proceedings to the District Court of Oklahoma.

V.

The Court erred in entering the order of October 19th, 1939 without notice to the attorney of record for the alleged bankrupt and the appellant herein.

VI.

The Court erred and exceeded its jurisdiction in proceeding to settle the receiver's report and the receiver's attorneys' fees.

VII.

The Court erred in denying the trustee's motion to vacate said order of October 19th, 1939, where said order was void and the Court had lost jurisdiction, and said order was entered in violation of the Bankruptcy Act and the General Orders in Bankruptcy.

Dated this 19th day of December, 1939.

FRANCIS B. COBB

Attorney for Appellant

Received copy of the within Appellant's Statement this 19th day of December, 1939.

RUPERT B. TURNBULL &
LEONARD J. MEYBERG
By RUPERT B. TURNBULL
By H. JODREY.

[Endorsed]: Filed Dec 21 1939. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF RECORD ON APPEAL.

To the Honorable Curtis D. Wilbur, Presiding Justice, and the Associate Justices of the United States Circuit Court of Appeals for the Ninth Circuit.

Pursuant to rules of practice of this Court, the appellant, P. M. Jackson, Trustee in Bankruptcy

for the Estate of Leonard J. Woodruff, bankrupt, does hereby designate the following documents, orders, judgments and records in the proceedings to be contained in the record on appeal in the above entitled matter, said documents being as follows:

1. Creditors' Petition in Bankruptcy filed July 13, 1939.

2. Answer of Alleged Bankrupt filed August 9, 1939.

3. Order Under General Order No. 6 with letter attached by the District Court for the Eastern District of Oklahoma filed October 18, 1939.

4. Order of October 19, 1939, entitled Order Directing Clerk to Stay Transmission of Records to the Clerk of the Eastern District of Oklahoma Until the Determination of Costs of Administration in This Jurisdiction, Order Requiring Receiver to File His Report and Account and Petition for Compensation, and Requiring Attorneys for the Receiver to File Their Petition for Compensation. Filed October 19, 1939.

5. Motion to Vacate Ex Parte Order of October 19, 1939, Staying Transmittal of Records. Filed November 2, 1939.

6. Order Appointing Attorney for Trustee. Filed November 2, 1939.

7. Memorandum of Order and Minute Order of November 15, 1939. Filed November 15, 1939.

8. Petition for Appeal and Notice of Appeal.

9. Order Allowing Appeal.

10. Assignment of Errors.

11. Appellant's Statement of the Points on Which he Intends to Rely on the Appeal.

12. Copy of Order Settling and Designating the Record on Appeal.

13. Petition for the Appointment of a Receiver.

14. Order Appointing Receiver.

15. Petition by Receiver for Instructions.

16. Order of the Court Made on Receiver's Petition and Instructions.

17. This Designation.

Dated this 19th day of December, 1939.

FRANCIS B. COBB
Attorney for Appellant

Received copy of the within Designation this 19th day of December, 1939.

RUPERT B. TURNBULL and
LEONARD J. MEYBERG
RUPERT B. TURNBULL
By H. JODREY
Attorneys for Receiver

[Endorsed]: Filed Dec 21 1939. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

COUNTER DESIGNATION OF CONTENTS OF RECORD ON APPEAL

To the Honorable Curtis D. Wilbur, Presiding Justice, and the Associate Justices of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now E. A. Lynch as receiver of the Estate of Leonard J. Woodruff, bankrupt, appellee herein, and files this, his objection to the designation of contents of record on appeal as filed by the appellant P. M. Jackson, and files this, his Counter Designation of Contents of Record on Appeal.

Appellee does designate the following documents, orders, records and stipulations in the proceedings to be contained in the record of appeal in the above entitled matter, in addition to the documents designated by the appellant, to-wit:

The stipulations of the parties had in open court on the date of the hearing of the motion of P. M. Jackson to vacate the order of October 19, 1939, which said stipulations were ordered included in the record by the order of the District Judge, the Honorable George Cosgrave, said stipulated facts being recited in said order and being as follows:

1. That if Rupert B. Turnbull was called as a witness he would now testify that an appeal has been perfected from the order of Judge Eugene Rice of the District Court of the United States of the Eastern District of Okla-

homa to the United States Circuit Court of Appeals for the Tenth Circuit, purporting to be made under General Order 6. That it be deemed that said Turnbull has been called and so testified, and that it was further stipulated that Leonard Woodruff, Bankrupt, petitioned voluntarily in the Eastern District of Oklahoma to be, and was, adjudicated on the sole ground that Woodruff had his principal place of business there.

2. That the petitioning creditor in the above entitled proceeding, M. E. Heiser, had actual knowledge at the date of the filing of the involuntary proceeding herein that Leonard J. Woodruff had filed a voluntary petition in Oklahoma on July 5, 1939, and that an order of adjudication had been entered thereon on July 5, 1939, which fact was then orally communicated to the District Judge at Los Angeles, California.

The foregoing is contained in the order of the District Judge entered December 7, 1939, entitled "Order Settling and Designating the Record on Appeal".

LEONARD J. MEYBERG
RUPERT B. TURNBULL
Attorneys for E. A. Lynch,
Receiver, Appellee.

Served copy on Hiram Casey, Atty. for Bankrupt and

Served copy on Francis Cobb, Atty. for P. M. Jackson December 21st, 1939, by Rupert B. Turnbull. See separate affidavit of service.

.....

Attorney for E. A. Lynch, Receiver, Appellee.

[Endorsed]: Filed Dec 23 1939. Paul P. O'Brien, Clerk.

No. 9401

In the United States Circuit Court of Appeals

For the Ninth Circuit.

P. M. JACKSON, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

Appellant,

vs.

E. A. LYNCH, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt,

Appellee.

APPELLANT'S OPENING BRIEF.

FRANCIS B. COBB,
506 L. A. Stock Exchange Office Building, Los Angeles,
Attorney for Appellant.

Parker & Baird Company, Law Printers, Los Angeles.

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES.

STATUTES.

No. 9401

In the United States Circuit Court of Appeals

For the Ninth Circuit.

P. M. JACKSON, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

Appellant,

vs.

E. A. LYNCH, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt,

Appellee.

APPELLANT'S OPENING BRIEF.

Statement of Jurisdiction.

The United States District Court for the Southern District of California claimed and asserted jurisdiction over the parties and the subject matter by reason of an involuntary petition in bankruptcy filed by one creditor against Leonard J. Woodruff [R. 3 to 7]. See Title 11, Chapter 2, Sec. 11, United States Code Annotated.

This court has jurisdiction by reason of section 24, subdivision (a) of the Bankruptcy Act, Title 11, Sec. 47, United States Code Annotated, p. 360.

Statement of the Case.

Leonard J. Woodruff was adjudicated a bankrupt on his voluntary petition therefor by the United States District Court for the Eastern District of Oklahoma on July 5, 1939, and P. M. Jackson was thereafter appointed and qualified as trustee in bankruptcy for the estate, [R. 51, 67].

On July 13, 1939, an involuntary petition seeking the adjudication of Leonard J. Woodruff as a bankrupt was filed with the United States District Court for the Southern District of California [R. 3 to 7] and E. A. Lynch was appointed receiver by the California District Court on application by a single petitioning creditor, without notice to the bankrupt or trustee or the Oklahoma court [R. 12].

The petitioning creditor had actual knowledge at the time he filed the involuntary petition that Woodruff had been previously adjudicated a bankrupt in Oklahoma [R. 67].

Woodruff filed an answer to the involuntary petition [R. 15 to 20].

The bankrupt and certain creditors moved the District Court in Oklahoma for an order under General Order No. 6 and after due notice was given to all interested parties a hearing was had on October 16, 1939 in Oklahoma, and an order was entered decreeing that the United States District Court for the Eastern District of Oklahoma was the court which could proceed with the greatest conveni-

ence to the parties interested, and further ordering the transfer of the proceedings in Southern California to Oklahoma, and ordering the trustee to take charge of the bankrupt's property wherever located, and that the possession of the trustee be exclusive [R. 40 to 42].

A copy of the order of the District Court of Oklahoma was sent to the clerk of the District Court in California and was received by him on October 18, 1939.

The District Court in California, without notice, on the 19th day of October, 1939, entered an order staying the transmittal of the records to Oklahoma, and ordering the receiver and his attorneys to file their accounts and petitions for fees [R. 43 to 46].

The trustee in bankruptcy then moved the California court to vacate the *ex parte* order entered on October 19, 1939, and the matter was heard, submitted and the District Judge wrote an opinion and order dated November 15, 1939 and entitled "Memorandum of Order" denying the motion [R. 51 to 55].

The Trustee has appealed from both the orders of October 19, 1939 and of November 15, 1939 [R. 56 and 60].

ARGUMENT.

The California District Court Exceeded Its Jurisdiction by the Ex Parte Order of October 19, 1939.

Upon the entry of an order of adjudication, title to all property of the bankrupt wherever situated vests in the trustee in bankruptcy as of that date, and the jurisdiction of the bankruptcy court making the adjudication was exclusive, and could not be affected by proceedings in any other court, state or federal.

Gross v. Irving Trust Co., 289 U. S. 342;

Isaacs v. Hobbs, 282 U. S. 734;

Gratiot County State Bank v. Johnson, 249 U. S. 246;

Meyer v. International Trust Company, 263 U. S. 64.

A case particularly in point is *In re Southern States Finance Co.,* 19 Fed. (2d) 959. An order of adjudication had been entered in Delaware. Later an involuntary was filed in North Carolina and a motion was made to transfer to North Carolina. The court stated the rule as follows:

> "But in the case at bar it is not necessary to go so far, for here the second petition was not filed until after the adjudication and qualification of the trustee. By the adjudication here made the status of the corporation as a bankrupt was fixed and established. Gratiot State Bank v. Johnson, 249 U. S. 246, 39 S. Ct., 263, 63 L. Ed. 587; Myers v. Trust Co., 263 U. S. 64, 73; 44 S. Ct. 86, 68 L. Ed. 165. That status could not be affected, either by the dismissal of the petition filed in North Carolina or by there carrying the proceedings to an adjudication. Moreover, the

title of the bankrupt to its nonexempt property passed from the bankrupt to the trustee here chosen upon his appointment and qualification (Bankruptcy Act, Sec. 70 (Comp. St. Sec. 9654), thus leaving no property, save that after-acquired, of which there is no suggestion, upon or with respect to which the court in North Carolina could exercise original jurisdiction. Nor is it shown that there are creditors of the bankrupt whose debts have arisen subsequent to the filing of the petition in this district. See Stolzenbach v. Penn-American Gas Coal Co., *supra*.

Since the court in North Carolina was without power by its decree to affect the status of the corporation, or to bring effectively within its grasp the property which had passed by operation of law from the corporation to the trustee in bankruptcy, here chosen and qualified before the petition was there filed, it would seem obvious that the power essential to the existence and exercise of original jurisdiction was wholly wanting. The power conferred by the statute to make an adjudication and to pass title to the trustee had been exercised, and by its exercise exhausted."

In the case of *In re Continental Coal Corp.*, 238 Fed. 113, the Sixth Circuit Court of Appeals passed on a dispute between the District Court for the Eastern District of Kentucky and the District Court for the Eastern District of Tennessee. There an involuntary petition in bankruptcy was filed in the Kentucky court and three days later a voluntary petition was filed in the Tennessee court. Both courts attempting to exercise jurisdiction, it became necessary to determine the nature and extent of the jurisdiction of the federal court in Kentucky. The opinion states:

"In Mueller v. Nugent, 184 U. S. 1, 22 Sup. Ct. 269, 46 L. Ed. 405, Mr. Chief Justice Fuller, speaking

for the Supreme Court said: '"It is as true of the present law as it was of that of 1867, that the filing of the petition is a caveat to all the world, and in effect an attachment and injunction (Bank v. Sherman, 101 U. S. 403 (25 L. Ed. 866); and on adjudication, title to the bankrupt's property became vested in the trustee (sections 70, 21e) with actual or constructive possession, and placed in the custody of the bankruptcy court. . . .'"

"It is thus clear that the filing of the petition in bankruptcy in the District Court for the Eastern District of Kentucky, and the issuing of process thereon, was an assertion of the jurisdiction of the court over the bankrupt's estate, and gave that court prior jurisdiction over the subject-matter, which jurisdiction was exclusive during the pendency of such proceedings for adjudication. It may be true that the court below did not have actual possession, through its officers, of the property of the bankrupt estate, but it cannot be denied with reason that the court had such possession of the bankrupt estate, as placed it in *custodia legis* . . . Acme Harvester Co. v. Beckman Lumber Co., 222 U. S. 307, 32 Sup. Ct. 96, 56 L. Ed., 208."

"The title of the trustee in bankruptcy, appointed under the involuntary proceedings so first begun would be fixed as of the time of the filing of the petition. (Citing cases.) . . ."

"If this were a case of concurrent jurisdiction on the part of the federal courts in Kentucky and Tennessee, then the question would be disposed of under section 32 of the Bankruptcy Act and General Order No. 6 (89 Fed. V, 32 C. C. A. IX), or if the courts had concurrent jurisdiction and section 32 and General Order No. 6 did not exist, then it would perhaps be held that the court first acquiring jurisdiction

would retain the case for the purpose of adjudging the defendant corporation a bankrupt, and settling and distributing its estate; but here one or the other of these courts has exclusive jurisdiction to entertain this case. The jurisdiction of the federal court in Kentucky first having been asserted on the filing of the involuntary petition, in the absence of any statute or general order in bankruptcy, we think both upon principle and authority, that the court in which jurisdiction was first asserted took constructive possession of the property of the bankrupt estate, and should retain the case for the purpose of determining the question of its own jurisdiction." (Citing several Supreme Court cases.)

The Supreme Court of the United States, in the leading case of *Isaac v. Hobbs, supra,* states the rule:

"Upon adjudication, title to the bankrupt's property vests in the trustee with actual or constructive possession and is placed in custody of the bankruptcy court. Mueller v. Nugent, 184 U. S. 1, 14. The title and right to possession of all property owned and possessed by the bankrupt vests in the trustee as of the date of the filing of the petition in bankruptcy, no matter whether situated within or without the district in which the court sits. (Citing cases.) It follows that the bankruptcy court has exclusive jurisdiction to deal with the property of the bankrupt estate. . . . When this jurisdiction has attached the court's possession cannot be affected by actions brought in *other courts.* . . ."

"The jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate and the preservation of the rights of both secured and unsecured creditors." (Italics supplied.)

Again the rule is stated as follows:

> "Upon adjudication in bankruptcy, all property of the bankrupt vests in the trustee as of the date of filing the petition. Upon the filing, the jurisdiction of the bankruptcy court becomes paramount and exclusive; and thereafter the court's possession and control of the estate cannot be affected by proceedings in other courts, whether state or federal." Citing Gross v. Irving Trust Co., 289 U. S. 342, 22 Am. B. R. (N. S.) 661, 53 S. Ct. 605, 77 L. Ed., 1243, 90 A. L. R. 1215; Acme Harvester Co. v. Beekman Lum. Co., 222 U. S. 300, 27 Am. B. R. 262, 32 S. Ct., 96, 56 L. Ed., 208; In re Diamond's Estate (C. C. A., 6th Cir.) 44 Am. B. R. 268, 259 F. 70."
>
> *Taylor v. Sternberg,* 27 Am. B. R. (N. S.) p. 1, 293 U. S. 470.

Under the above decisions, the jurisdiction of the District Court in Oklahoma was exclusive and the title to the bankrupt's property was exclusively in P. M. Jackson, as trustee, and the District Court of California had no jurisdiction to appoint a receiver or order the receiver or his attorneys' fees paid out of property then in *custodia legis.* To allow the California court to do so would be to permit the California court to create a lien and charge on the assets in *custodia legis* of the Oklahoma court after July 5, 1939. Likewise for the California court not to give full faith and credit to the judgment of adjudication of the Oklahoma court, besides violates a well recognized doctrine of comity that where two courts having concurrent jurisdiction the one first proceeding to judgment exhausted the jurisdiction of the other court.

No Ancillary Proceedings Were Instituted and the California Court Had No Jurisdiction to Appoint a Receiver or Hold Possession of the Assets.

An adjudication having been entered in Oklahoma prior to any proceedings in the California court, on the above cases cited the Oklahoma court had exclusive jurisdiction. Before ancillary proceedings could be instituted in California, General Order No. 51 would have had to be complied with. Said General Order provides:

> "No ancillary receiver shall be appointed *in any* District Court of the United States in any bankruptcy proceeding pending in any other district of the United States except (1) upon the application of the primary receiver, or (2) upon application of any party in interest *with the consent of the primary receiver*, or by leave of a judge of the court of original jurisdiction."

Then follows a statement of requirements of the petition.

Proceedings under General Order No. 51 were not instituted in this case, but a single creditor attempted to file an involuntary proceeding with actual knowledge of the previous adjudication in bankruptcy.

Where adjudication promptly follows the filing of the petition against a corporation in the district of its domicile, the jurisdiction of that court is exclusive over all proceedings in the matter. Using the language of *In re United Button Co.*, 12 A. B. R. 761, 132 Fed. 378:

> "However, it may be difficult to understand how a corporation or any other person once adjudged a bankrupt by a competent court, whatever the relative date of filing the petition, can again be decreed a bankrupt

by a court in a proceeding not ancillary. When a competent court has adjudged that judgment is final as to the bankrupt and his creditors, and another court cannot superimpose in an independent judgment in a separate proceeding; otherwise the judgment would not be an estoppel."

The Order of October 19, 1939, Violated General Order No. 6 and Section 32 of the Bankruptcy Act.

If this court differs with appellant that the California court had jurisdiction, then the orders appealed from violated section 32 of the Bankruptcy Act and General Order No. 6 promulgated by the Supreme Court. The Bankruptcy Act provides:

> "In the event petitions are filed by or against the same person or by or against different members of a partnership, in different courts of bankruptcy each of which has jurisdiction, the cases shall, by order of the court first acquiring jurisdiction, be transferred to and consolidated in the court which can proceed with the same for the greatest convenience of parties in interest."

General Order No. 6 provides:

> "If two or more petitions are filed by or against the same person or by or against different members of a partnership in different courts of bankruptcy, each of which has jurisdiction, the court first acquiring jurisdiction shall, upon application by any party in interest and after a hearing upon reasonable notice to parties in interest, determine the court in which the cases can proceed with the greatest convenience to parties in interest, and the proceedings upon the other petitions shall be stayed by the courts in which such

> petitions have been filed until such determination is made. If the court first acquiring jurisdiction determines that it shall hear the cases, it shall make its order to that effect, and other courts in which petitions have been filed, upon exhibition of a certified copy of such order, shall order the cases before them transferred to the court first acquiring jurisdiction. If the court first acquiring jurisdiction determines that the cases shall be heard by another court, it shall make its order to that effect and that the case before it be transferred to such court; and other courts in which petitions have been filed, upon exhibition of a certified copy of such order, shall order the cases before them transferred to the court named in the order of the court first acquiring jurisdiction."

A hearing was had in the District Court of Oklahoma after notice to all parties in interest and that court determined that all matters could proceed in Oklahoma with the greatest convenience to all parties in interest [R. 40 to 42] and further ordered that the proceeding in California be transferred and consolidated with the proceeding in Oklahoma [R. 42].

The District Court in California has prevented the clerk of its court from complying with General Order No. 6, and has tried to reserve unto itself the privilege of making future orders in respect to the administration and properties, as it is provided in the order [R. 45]:

> "IT IS HEREBY ORDERED that the Clerk of the District Court of the United States for the Southern District of California, Central Division, stay the transmittal of the records in this proceeding as the

> same exist in this jurisdiction until such time as this Court shall have made its further orders approving, or disapproving, the report and account filed by the Receiver as appointed by this Court, and shall have made the allowance to the Receiver and to his attorneys for compensation and for expenses, and shall have made an order with respect to the payment thereof; . . ."

To permit the practice indulged in by the California District Court would be to allow Jackson as trustee as owner of the bankrupt's property for which he is liable on his bond and which property was in *custodia legis* to be taken by another court with knowledge of these rights, held by another court through its receiver, charge the property with a lien for administration cost in flagrant disregard of the true owner's rights. We submit this is not the law and it was the intention of the Supreme Court in promulgating General Order No. 51, to not permit another court to appoint ancillary receiver without the consent of the court of original jurisdiction or on petition of the primary receiver. The practice here indulged in would make General Order No. 51 meaningless.

In the instance of a conflict between the state court of Missouri and a District Court of the United States, the question of jurisdiction in a bankruptcy arose over the disputed possession of property. The petitioning trustee in the Federal Court sought and obtained an order for possession of the property.

The opinion states the situation as to any asserted claims for services or care and custody of the property while under the assumed jurisdiction of the state court:

> "As the circuit court of Clark county had no jurisdiction over the property in the possession of its receiver, it had no authority to dispose of any portion of such property or its proceeds. If any expenses have been incurred, or any services rendered in the care and preservation of the property, they will, no doubt, be allowed by the United States District Court for the Southern District of Iowa, which court alone has jurisdiction to impose charges upon this property.
>
> *In re Sage,* 224 Fed. 525, *State of Missouri v. Angle* (affirmed in 236 Fed. p. 644).

See also:

> *State of Missouri v. Angle,* 236 Fed. 644,

wherein the following language appears upon the matter of a court, acting in excess of its jurisdiction, attempting to compensate its appointee for services. At page 653 the court said:

> "As the state court was without authority to administer any portion of the assets of David H. Sage, it must be without power to award compensation to its officer for performing part of that labor. So far as those services were of value to the estate, in preserving and collecting it, an application to the court of bankruptcy will afford an avenue of relief. Randolph v. Scruggs, 190 U. S. 533, 23 Sup. Ct. 710, 47 L. Ed., 1165."

See also, on the same point, the late United States Supreme Court decision in *Taylor v. Sternberg, supra.*

No Reason Has Been Shown Why the Oklahoma Court Cannot Proceed With All Future Matters.

The Oklahoma court has determined that it can proceed with the greatest convenience to all parties in the future, and we see no reason why, after consolidation, all proceedings should not be had in one court instead of continuing the interference by the District Court of California with the trustee's ownership and rights. To show where this would lead: the California court would order a sale of Jackson's property to pay allowances made by it after title and possession was vested in the trustee. This is in violation of the Bankruptcy Act in spirit as well as letter. (See Section 32.)

It is urged that the relief herein sought is fully justified upon lawful, practical and fair considerations of the substantial rights of all creditors of the estate and of the bankrupt, in order to further the equitable objectives of the administration of the bankruptcy estate.

Furthermore, upon the grounds of comity, the orderly and economical administration of justice, as fixed by statute and declared by judicial decisions, this court should establish the lawful and exclusive jurisdiction of the United States District Court for the Eastern District of Oklahoma, so far as the matter in controversy is concerned, and set aside the orders appealed from.

Wherefore, it is respectfully submitted that, upon the authorities and law herein cited, the orders appealed from be set aside.

Respectfully submitted,

FRANCIS B. COBB,
Attorney for Appellant.

No. 9401.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

P. M. JACKSON, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

Appellant,

vs.

E. A. LYNCH, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, alleged bankrupt,

Appellee.

BRIEF OF APPELLEE.

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Parker & Baird Company, Law Printers, Los Angeles.

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No. 9401.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

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vs.

E. A. Lynch, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, alleged bankrupt,

Appellee.

BRIEF OF APPELLEE.

Statement of the Facts.

Leonard J. Woodruff, the bankrupt, is a judgment debtor of M. E. Heiser. Heiser obtained a judgment in the District Court of the Southern District of California for a total of $278,000.00 against said Woodruff in an action entitled *Heiser v. Woodruff*. Concerning that case this Court is now familiar as it is now before this Circuit Court on an abortive attempt to appeal from the final judgment in that case.

Heiser, through his counsel, stipulated to a stay of execution on that judgment, the stay to run to July 6, 1939. Woodruff had been strenuously asserting that sub-

stituted service of process on him in California was defective because, he asserted, his residence had been and was at 2446 Inverness avenue, Los Angeles, California, and that he was away from his home only temporarily to buy cattle in the state of Oklahoma. The day before the stay of execution expired, to wit, on July 5, 1939, Woodruff appeared at Muskogee, Oklahoma, and filed his voluntary petition in bankruptcy, alleging that his principal place of business for the greater part of the preceding six months was Carter county, Oklahoma. [Tr. p. 66.] He did not claim residence or domicile in Oklahoma. He filed his schedules in bankruptcy in Oklahoma and DID NOT list his California properties.

The California properties of the bankrupt Woodruff were extensive, consisting principally of a business block located at Los Angeles, on Hollywood boulevard, for which he had paid $225,000.00 [Tr. p. 29], and a set of four antique stores housed on said premises stocked with antiques, oriental goods, Indian goods, medieval arms [Tr. p. 29], which were appraised in this proceeding as of the value of $84,000.00, and a stock of raw sapphires and opals in warehouse.

There was no inventory of any kind of said Los Angeles antique stores or of the raw gems valued at $30,000.00.

There was no insurance on either said real or personal properties.

No receiver was appointed by the Oklahoma District Court.

No receiver or trustee from Oklahoma appeared in California to preserve, claim, inventory, insure or care for the California properties until P. M. Jackson, Trustee, from Oklahoma, appeared in this proceeding with his mo-

tion to vacate for the first time on November 17, 1939—more than four months after E. A. Lynch, Receiver, was appointed receiver by the California District Court, and had done all his work and made all his expenditures.

On application of the petitioning creditor in the District Court of the Southern District of California, Judge William P. James at Los Angeles made his order appointing E. A. Lynch as receiver, Judge James being then advised of the bankruptcy proceeding of Woodruff in Oklahoma. [Tr. p. 67.] By the order of his appointment, Lynch was charged with preserving, insuring and operating the properties of the bankrupt, and particularly the stores of the bankrupt at Los Angeles known as Woodruff Antique Stores.

The question of which court is primary, and which is secondary, is still undetermined, as an attack was made by creditors upon the jurisdiction of the Oklahoma court and likewise by creditors upon the order under General Order No. 6 as made by the Oklahoma court, and both of these questions are now on appeal before the Circuit Court of Appeals for the Tenth Circuit, being known and docketed in said circuit as No. 2024. [Tr. p. 66, subdivisions 1 to 16.]

The residence, the domicile and the principal place of business of Woodruff were at Los Angeles, in the Southern District of California. The principal and only place of business of the bankrupt, creditors contend, was the place on Hollywood boulevard, Los Angeles, California, the site of the antique stores, investments in buildings, personal properties, and so forth, of a value in excess of $300,000.00. [Tr. p. 29.] There being no inventory of any kind of these extensive antique stores—some 25,000

separate articles, some genuine antiques and oil paintings, some reproductions, some imitations—and no insurance thereon. On application of the California receiver, E. A. Lynch, the District Court for the Southern District of California, by the Honorable Paul J. McCormick, Judge, made an order for the examination of the bankrupt Woodruff in the Eastern District of Oklahoma. The California receiver, E. A. Lynch, then sent one of his local counsel, Rupert B. Turnbull, to Oklahoma to obtain information from the bankrupt by the examination of the bankrupt.

The Referee in Bankruptcy in Oklahoma refused permission to examine the bankrupt and E. A. Lynch reported such situation to the District Judge in California, the Honorable Paul J. McCormick, by an additional petition for instructions as follows:

> "Comes now E. A. Lynch, as receiver of the estate of Leonard J. Woodruff, a bankrupt, and respectfully shows to the Court:
>
> 1. That your petitioner, E. A. Lynch, is the duly appointed, qualified and acting receiver of the estate of Leonard J. Woodruff in the Southern District of California, having been appointed by an order of this court dated July 14, 1939.
>
> 2. That as receiver your petitioner has taken into actual possession, and is in possession of, a store building situated at the juncture of Hollywood Boulevard and Sunset Boulevard, which your petitioner alleges he was informed was purchased by the bankrupt at the cost of approximately $225,000.00. That your petitioner as such has taken possession of the stock in trade of merchandise in four stores located in said building known as Woodruff Antique Stores, consisting of, first, general stock of antiques, repro-

ductions and imitations, pictures, prints, coppers, etc.; second, a stock of Oriental goods; third, a stock of Indian goods and Indian baskets, saddles, etc.; fourth, stock of firearms and a collection of medieval arms and objects of warfare.

There is in existence no inventory of said stock, which are very extensive. That there is no memorandum or books from which it can be ascertained what the cost of said merchandise was, or of its present value. The property was not insured at the time of bankruptcy and your petitioner has been uncertain as to the amount of [24] insurance to be placed thereon, but has covered it for fire loss purposes at the present time in the amount of $30,000.00. That your petitioner has no inventory and so notified the insurance companies carrying said fire loss insurance policies.

That your petitioner has heretofore petitioned this court for authority to instruct one of his counsel to examine the bankrupt concerning the nature, extent and value of the properties reduced to possession by your receiver, and pursuant to an order made by this court in that behalf your receiver has caused Rupert B. Turnbull, one of his counsel, to proceed to Ardmore, Oklahoma, for the examination for the purpose of obtaining information from the bankrupt by examination to be conducted before the referee in bankruptcy, the Honorable George F. Clark. That a bankruptcy proceeding is pending in the Eastern District of Oklahoma relating to the same bankrupt herein, Leonard J. Woodruff, and the matter has been referred, both specially and generally, as referee and special master, to the Honorable George F. Clark, sitting at Ardmore, Carter County, Oklahoma. That Rupert B. Turnbull did proceed to Ardmore, Oklahoma, and appeared on behalf of your receiver and

one of his attorneys, before the Honorable George F. Clark, referee in bankruptcy, sitting in the District Courtroom in the Federal Building, at Ardmore, Oklahoma, on Friday, the 11th day of August, 1939. That at said time the said bankrupt, Leonard J. Woodruff, was present. Said Rupert B. Turnbull having theretofore communicated with the said referee in bankruptcy requested the production of the bankrupt at such time. That at such time and upon the calling of the Court at 1:30 P. M. on the 11th day of August, 1939, substantially, but not verbatim, the following occurred:

By Mr. Turnbull: May I proceed?

By the Court: Yes.

By Mr. Turnbull: My name is Rupert B. Turnbull and I represent to the Court at this time that there is pending in the Southern District [25] of California, in the District Court at that place, an involuntary proceeding against Leonard J. Woodruff. In that proceeding the Court has made its order appointing E. A. Lynch as receiver. In support of that statement I hand your Honor herewith a certified copy of the order appointing E. A. Lynch as receiver. (Thereupon there was handed to the Court a certified copy of the order made by this court appointing E. A. Lynch receiver.) I represent to your Honor that I am one of the attorneys employed by that receiver, E. A. Lynch, pursuant to an order of that court. I hand you herewith in support of that statement a copy of the order of the District Court of Southern District of California, authorizing such employment. I represent to your Honor that I now appear as the attorney for said receiver, E. A. Lynch, and pursuant to an order of the District Court of the Southern District of California authorizing E. A. Lynch to

instruct me to appear here and examine Leonard Woodruff concerning the nature, extent and value of the property in the Southern District of California, and for the purpose of properly preserving, inventorying and insuring that property adequately, I ask the privilege of examining the said Leonard Woodruff at this time for the limited purpose as I have stated.

That at said time Leonard Woodruff was in the courtroom available for such examination. That at such time he was represented by his counsel, Champion, Champion and Fischel. That Louis Fischel arose and addressed the Court on behalf of the bankrupt and stated to the Court that the receiver in the California Court was an interloper, had no rights before the Oklahoma Courts, and that this, the District Court for Eastern Oklahoma, should refuse him any rights of examination of the bankrupt for any purposes. Thereupon Rupert B. Turnbull, acting as attorney for E. A. Lynch, stated to the Court, truthfully, that the receiver in California was in a very uncomfortable position in that he had been ordered by the District Court in Southern California to merger, preserve and insure [26] the property. That he thought he was entitled to the aid of the bankrupt and the knowledge of the bankrupt concerning the nature, extent and value of these antiques and other collections, and also with respect to other property which had been located by the receiver, which property belonged to the bankrupt, which is not inventoried in the bankrupt schedules as filed in the District Court in the Eastern District of Oklahoma. Thereupon the court sustained the objection of counsel for bankrupt and refused permission to Rupert B. Turnbull, acting as attorney for the receiver, E. A. Lynch, to examine the bankrupt, Leonard J. Woodruff, notwithstanding that he was personally present at the Court at the said time." [Tr. pp. 29-33 incl.]

The trustee appointed by the Oklahoma court is the official who now challenges the right of the California District Court to require, for approval or disapproval, the report and account of his own receiver, E. A. Lynch; that Trustee P. M. Jackson is the official who left uninsured, uninventoried and unprotected extensive properties of the bankrupt, real and personal, of a value in excess of $300,000.00, and all on the ground that they were not scheduled in the Oklahoma bankruptcy proceeding.

The Oklahoma District Court on October 16, 1939, made its order under General Order No. 6 determining that, there being two district courts having jurisdiction of the bankrupt's properties—one in the Southern District of California and one in the Eastern District of Oklahoma—that

> "this court can proceed with the administration of the bankrupt's estate with the greatest convenience to the parties interested in said estate." [Tr. p. 41.]

And also:

> "The Court further finds that on the 13th day of July, 1939, M. E. Heiser, one of the creditors of bankrupt, filed an involuntary petition in bankruptcy in the United States District Court for the Southern District of California, Central Division, being cause No. 34521-J in Bankruptcy therein and that E. A. Lynch was appointed receiver in said action and is now acting as such receiver; that said proceeding should be transferred to this Court and this judicial district and should be *consolidated* with this case and that the trustee should take charge of all of the property of the bankrupt including that located in California." [Tr. p. 41.]

Upon transmittal of that order under General Order No. 6, as made by the Oklahoma court, the District Court for the Southern District of California DID NOT defy the order of the Oklahoma court, but instead it merely made its order directing the clerk to delay the transmission of its own California records to Oklahoma until after the District Court of the Southern District of California could promptly obtain an account and report of its own receiver, E. A. Lynch, and that order directed the said receiver to file within five days his report and account, as appears from said order which appears in its entirety in the record herein. [Tr. pp. 43-46 incl.] It is the refusal of the California court to vacate that order that results in the present appeal by the appellant herein.

The memorandum of order by the District Judge for the United States District Court, Southern District of California, justifying his refusal to vacate that order, appears in the record herein [Tr. pp. 51-55 incl.] and reads as follows:

> "In the Matter of Leonard J. Woodruff, Alleged Bankrupt.
>
> MEMORANDUM OF ORDER.
>
> Cosgrave, District Judge.
>
> Leonard J. Woodruff was adjudicated a bankrupt on his voluntary petition therefor in the Eastern District of Oklahoma on July 5, 1939, and P. M. Jackson since has been appointed trustee of the bankrupt estate. On July 13, 1939, an involuntary petition seeking the adjudication of Leonard J. Woodruff as

a bankrupt was filed in the Southern District of California. On petition setting up legal necessity therefor, E. A. Lynch was appointed receiver under the involuntary petition by the California court, and authorized to employ counsel. A considerable amount of real, as well as personal property, the latter being an extensive store for the sale and rental of antiques, was located in California, and the receiver was authorized to operate this business.

On October 16, 1939, the court in Oklahoma, acting under General Order in Bankruptcy No. 6, after application therefor and hearing on such application, found the Eastern District of Oklahoma to be the domicile of the bankrupt during the required period, and also found it to be the principal place of business of the bankrupt, and because of these and other entirely sufficient reasons, that court found that it is the court which can proceed with the administration of the bankrupt's estate with the greatest convenience to the parties interested. The court then by its decree adjudged accordingly, and by its order transferred the case pending in the Southern District of California to the Eastern District of Oklahoma, and consolidated it with the case pending in the last named district.

Mr. Lynch, the receiver in California, does not question [42] the effectiveness of the decision of the Oklahoma court, since it was the first to acquire jurisdiction, but he insists that this court must settle his account as receiver before the case is transferred. Immediately after the filing in the office of the Clerk

of this court of a certified copy of the decree of the Oklahoma court, Mr. Lynch procured an ex parte order delaying the execution of the decree of the Oklahome court until his said account is settled. Mr. Jackson, trustee in the Oklahoma proceeding, now moves this court to set aside its order staying the transfer of the case, and instead to order such transfer forthwith. The question presented, therefore, is whether this court has jurisdiction and duty to settle the account of the California receiver before the case is transferred to the Eastern District of Oklahoma.

The involuntary petition filed in California alleges that the residence, domicile, and principal place of business of the bankrupt is in this district. The Oklahoma court finds that the domicile and principal place of business of the bankrupt is in the Eastern District of Oklahoma.

It is plain that the California court is not without jurisdiction in the premises. The District Court may:

'adjudge persons bankrupt who have had their principal place of business, resided or had their domicile within their (the court's) respective territorial jurisdiction for the preceding six months.' Bankruptcy Act 2, a (1).

In fact, the order of the Oklahoma court presumes this to be the case for that order is based on General Order No. 6:

'If two or more petitions are filed by or against the same person * * * in different courts, EACH OF WHICH HAS JURISDICTION * * * etc.'

which General Order is itself based on Section 32 of the Bankruptcy Act (11 U. S. C. 55):

'In the event petitions are filed by or against the same person * * * in different courts of bankruptcy, EACH OF WHICH HAS JURISDICTION, the case shall, by order of the court first acquiring jurisdiction, be transferred to and consolidated [43] in the court which can proceed with the same for the greatest convenience of parties in interest.'

It was a matter of uncertainty at the time that the involuntary petition was filed in California in which jurisdiction the administration of the estate finally would be had.

It is true that the California proceeding is not ancillary to that in Oklahoma (Bankruptcy Act, 2, a (20), 69, c, General Order 51) within the meaning of the Bankruptcy Act.

The action here invoked by the California receiver is not in the administration of the bankrupt estate as such. It must be assumed that on the showing made in his petition this court exercised a sound discretion in the appointment of a receiver. Plainly, it was a part of prudence to insure the property and keep it intact. A duty is imposed on every court, having property in its possession, to preserve the same and to control and to compensate its own officers in the performance of their duties with respect to such property.

The motion of Mr. Jackson must be denied, and it is so ordered.

November 15, 1939.

[Endorsed]: Filed Nov. 15, 1939. [44]"

The District Court for the Southern District of California Properly Exercised Its Jurisdiction Over Property of the Bankrupt Within Its Territorial Limits, Which Property Was Not Scheduled by the Bankrupt in His Voluntary Oklahoma Proceedings.

Under the Bankruptcy Act the bankrupt can be adjudicated in the place where he has either his residence, his domicile, or his principal place of business.

> "A district court of the United States, sitting as a court of bankruptcy, is a court of limited jurisdiction. Limitations exist as to subject matter; as to territory; as to residence and occupation of the debtor to be adjudicated: * * * and consent cannot confer jurisdiction over subject matter. The express provisions of the statute and necessary implication are controlling."
>
> *Nixon v. Michaels,* 38 Fed. (2d) 420.

> "He was a sojourner merely, and not a resident, of East St. Louis. We look upon this transaction as an imposition upon the jurisdiction of the court. The Congress did not intend *that one may select any court of bankruptcy which he pleases in these broad United States,* and be enabled, through a pretentious removal to the district of that court, to obtain his discharge from his debts. To allow that to be done would open the door to grave frauds upon creditors, which we are not disposed to countenance." (Italics ours.)
>
> *In re Garneau,* 11 A. B. R. 679, 127 Fed. 677 (C. C. A., Ill.), cited by *Remington on Bankruptcy,* Vol. 1, p. 71; also citing *In re Sutter,* 46 A. B. R. 267, 270 Fed. 248.

Creditors may interpose jurisdictional questions in a voluntary bankruptcy and after adjudication.

See:

In re San Antonio Land Co., 36 A. B. R. 512, 228 Fed. 984;

In re Guancevi Tunnel Co., 29 A. B. R. 229, 201 Fed. 316 (C. C. A., N. Y.);

In re Waxelman, 3 A. B. R. 395, 98 Fed. 589;

Niagara Contracting Co., 11 A. B. R. 645, 127 Fed. 782;

German v. Franklin, 9 Sup. Ct. Rep. 159, 128 U. S. 52, 32 L. Ed. 519;

Nixon v. Michaels, 38 Fed. (2d) 420, 15 A. B. R. (N. S.) 489 (C. C. A., Mo.).

The alleged bankrupt cannot confer jurisdiction upon a court not having jurisdiction of the subject matter or of the person.

> "But assuredly, neither consent nor waiver can confer jurisdiction in the bankruptcy court of one district to adjudge bankrupt a debtor not resident, domiciled nor having his principal place of business therein, although the ascertainment of such jurisdictional fact must be left in the same court for determination and its determination may not be subject to collateral attack."
>
> *Remington on Bankruptcy,* Vol. 1, p. 72.

The bankruptcy court has jurisdiction to determine whether the debtor belongs to the class subject to bankruptcy in that jurisdiction.

> "No one may be adjudged bankrupt upon his own petition or upon the petition of another, by his own

consent or contrary thereto, except by the bankruptcy court of the district where he has had either his residence, domicile or principal place of business for the six months, or for the greater portion thereof, preceding the filing of the petition."

Statement from the text of *Remington on Bankruptcy,* Vol. 1, p. 75, and citing:

In re Williams, 9 A. B. R. 736;

In re Mitchell, 33 A. B. R. 463;

In re Elmire Steel Co., 5 A. B. R. 485;

In re Garneau, 11 A. B. R. (C. C. A., Ill.).

"An established domicile is presumed to continue down to the filing of the petition, in the absence of proof to the contrary. These limitations as to residence, domicile and principal place of business are jurisdictional, pertaining to jurisdiction over the subject matter; and they cannot be waived."

Remington on Bankruptcy, Vol. 1, p. 76, citing authorities heretofore quoted.

The District Court for the Southern District of California exercised its jurisdiction over property of the bankrupt within its territorial jurisdiction limits: (1) Because a bankruptcy proceeding purporting to be a primary petition had been filed in its jurisdiction; (2) by the order of Judge James appointing a receiver for the California properties; (3) by an order of Judge McCormick ordering the receiver to examine the bankrupt in Oklahoma in aid of the proceedings in California; (4) by the order of Judge Cosgrove staying the transmittal of the California proceeding records to Oklahoma *only* until the California court should obtain the report and account of its own receiver, to wit, the appellee E. A. Lynch.

The latter delay was necessary to determine what property said receiver had reduced to possession in California, to approve or disapprove the correctness of the receiver's account and expenditures, and to provide for the receiver's compensation rather than send him back two thousand miles to Oklahoma to have his account settled and allowed

In no other manner could the judges of the California District Court control their own officers, the Receiver E. A. Lynch being only "the long arm of the court" by and through which the court acts.

The Jurisdiction in This Case Is Either Primary or Ancillary. If Primary, the Following Applies:

In June, 1910, Congress amended the Bankruptcy Act so that it read that the district courts

> "are hereby invested within their respective territorial limits as now established or as they may be hereafter changed with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings in vacation, in chambers, and during their respective terms, as they or now or may hereafter be held. * * *"

In the case of *Babbitt v. Dutcher*, 216 U. S. 101, Chief Justice Fuller delivered the opinion of the court and quoted with approval the opinion of Justice Bradley in the case of *Sherman v. Bingham* (Supreme Court) as follows:

> " 'Their jurisdiction is confined to their respective districts, it is true, but it extends to all matters and proceedings in bankruptcy without limitation. When the act says that they shall have jurisdiction in their respective districts, it means that the jurisdiction is exercised in their respective districts, each court with-

in its own district may exercise the powers conferred; but those powers extend to all matters of bankruptcy without limitation. There are, it is true, limitations elsewhere in the act, but they affect only the matters to which they relate. * * *'

"But the exclusion of other district courts from jurisdiction of these proceedings does not prevent them from exercising jurisdiction in matters growing out of or connected with that identical bankruptcy so far as it does not trench upon or conflict with the jurisdiction of the court in which the case is pending. * * * That the courts of such other districts may exercise jurisdiction, in such cases, would seem to be the necessary result of the general jurisdiction conferred upon them, and is in harmony with the scope and design of the act."

Babbitt v. Dutcher, supra.

If the Jurisdiction in This Case Is Ancillary, the Following Applies:

The amendment in 1910 above referred to continued, under section 2, subdivision 20, that the courts are invested within their respective territorial limits to

"exercise ancillary jurisdiction over persons or property within their respective territorial limits in aid of a receiver or trustee appointed in any bankruptcy proceedings pending in any other court of bankruptcy."

U. S. Compiled Statutes 1901, p. 3420, as amended by Act June 25, 1910; *U. S. Compiled Statutes* Supp. 1911, p. 1491.

A District Court May Not Exercise Its Power Outside Its Respective Territorial Limits.

In the case of *Fidelity Trust v. Gaskell,* 195 Fed. 865, at page 871, the Court said:

> "Moreover, it seems to be settled by the decisions in Babbitt v. Dutcher, and other cases, that the limitation of section 2 of the Bankruptcy Act of the jurisdiction granted to the district courts in bankruptcy to 'their respective territorial limits' restricts the exercise of the power of a district court in which a petition in bankruptcy is filed to its own district, and that it may not enforce its process or its order for the delivery of property without the territorial limits of its district."

Citing:

Lathrop v. Drake, 91 U. S. 516, 517, 23 L. Ed. 414;

Babbitt v. Dutcher, 216 U. S. 102, 110, 30 Sup. Ct. 372, 54 L. Ed. 402, 17 Ann. Cas. 969;

Staunton v. Wooden, 179 Fed. 61, 64, 102 C. C. A. 355;

In re Peiser (D. C.), 115 Fed. 199, 200;

In re Sutter Bros. (D. C.), 131 Fed. 654;

In re Benedict (D. C.), 140 Fed. 55;

In re Robinson (D. C.), 179 Fed. 724.

> "It is therefore no longer true that one court, the court making the adjudication in bankruptcy, takes exclusive jurisdiction and alone collects and determines the titles to and liens upon the property wherever situated claimed as part of the estate of the bankrupt."

Fidelity Trust v. Gaskell, supra.

"A proceeding in bankruptcy is a proceeding in equity, and a district court sitting in bankruptcy, whether it is exercising its primary or its ancillary jurisdiction, is a court of equity. It is an established principle of equity jurisprudence that whenever a court of chancery takes into its legal custody, and thereby withdraws and withholds property from replevin, attachment, or other legal proceedings, it hears and adjudges the claims to the title and the legal and equitable liens upon that property of all parties who intervene in the suit or proceedings before it, in their own behalf, and submit their claims to its adjudication."

Fidelity Trust v. Gaskell, supra.

The *Chandler Act,* effective September 22, 1938, definitely determined the controversy, if any, that existed prior to that date concerning the duties and powers of ancillary jurisdiction. Prior to the enactment of this act, there was a difference of opinion among the district and the circuit courts as to the right of the ancillary courts to sell assets, fix fees, and pay expenses of the ancillary estate; and prior to this act the weight of respectable authority was that the ancillary court *did have* such authority. The Chandler Act definitely settles the controversy and fixes upon the ancillary court the *duty* and the *right so to do.*

Section 2a, subdivision (20), reads:

"Exercise ancillary jurisdiction over persons or property within their respective territorial limits in aid of a receiver or trustee appointed in any bank-

> ruptcy proceedings pending in any other court of bankruptcy: Provided, However, That the jurisdiction of the ancillary court over a bankrupt's property which it takes into custody shall not extend beyond preserving such property and, where necessary, conducting the business of the bankrupt, and reducing the property to money, paying therefrom such liens as the court shall find valid and the expenses of ancillary administration, and transmitting the property or its proceeds to the court of primary jurisdiction; and * * *"

In *Elkins, Petitioner in the Matter of Madison Steele Co., Bankrupt,* 216 U. S. 115 (C. C. A., 2d Circuit), the Court ends its decision with the following answer to its own question:

> "Have the respective district courts of the United States sitting in bankruptcy ancillary jurisdiction to make orders and issue process in aid of proceedings pending and being administered in the district court of another district? On the authority of Babbitt v. Dutcher, just decided (216 U. S. 102, *ante* 402, 30 Supreme Court Reps. 372), we answer both questions in the affirmative and it will be so certified."

That decision held that a district court under its primary jurisdiction can do all, each and every act under the Bankruptcy Act with respect to persons and property of the bankrupt within its jurisdiction, even though another bankruptcy of such person is pending in another district.

Ancillary Jurisdiction Does Not Depend Upon Any Statute but Rests on Possession of the Property Within the Territorial Jurisdiction of the Court.

"In the courts of the United States this ancillary jurisdiction may be exercised though it is not authorized by any statute. The jurisdiction in such *cases arises out of possession of the property,* and is exclusive of the jurisdiction of all other courts although otherwise the controversy would be cognizable in them. *Murphy v. John Hoffman Co.,* 211 U. S. 562, 569."

Butler v. Ellis, 45 Fed. (2d) 951, at p. 953.

"There the rule is no different, we think, in bankruptcy proceedings where the court of ancillary jurisdiction is proceeding under the bankruptcy statute. The leading case on the subject is Fidelity Trust Company v. Gaskell (C. C. A. 8th), 195 Fed. 865, 871, in which the late Judge Sanborn went into the matter very fully and stated the rule applicable as follows: 'A proceeding in bankruptcy is a proceeding in equity, and a district court sitting in bankruptcy, whether it is exercising its primary or its ancillary jurisdiction, is a court of equity. It is an established principle of equity jurisprudence that whenever a court of chancery takes into its legal custody, and thereby withdraws and withholds property from replevin, attachment, or other legal proceedings, it hears and adjudges the claims to the title and to legal and equitable liens upon the property of all parties who intervene in the suit, etc. . . .'"

Butler v. Ellis, supra.

This case of *Butler v. Ellis, supra,* being a decision in the Circuit Court of Appeals for the Second Circuit, directly decided the following matters:

First, that a district court could seize and had seized property of the bankrupt, which property was within the court's territorial jurisdiction;

Second, that that court had jurisdiction to determine the liens against the property within its jurisdiction, and had jurisdiction to fix the amount of allowance for compensation to its receiver and to the attorneys for its receiver;

Third, that the court could order the sale of sufficient of the property within its territorial jurisdiction to pay such claims, liens, fees and costs of administration.

The Court in its opinion said:

> "It is unthinkable that in authorizing the district courts to exercise ancillary jurisdiction in aid of a receiver or trustee in bankruptcy appointed in another jurisdiction, it was intended that these courts should do no more than seize property designated by the officer of the foreign court, and without hearing those who claim the property or an interest therein, turn it over to be administered in a jurisdiction hundreds of miles removed from the residence of the claimants. The first duty of the court is to do justice; and it is manifest that when through its receiver it lays its hands on property and thus renders it impossible for any other court to determine the ownership thereof or of the right of property therein, justice requires that it should itself hear and pass upon the claims of those who assert that the property belongs to them and not to the bankrupt.
>
> *Butler v. Ellis, supra.*

"On the third question, however, we think that the learned judge below was in error in confirming a sale of the property and in allowing fees to the receiver and attorneys, without giving notice to creditors or observing the limitations on allowance prescribed by the Bankruptcy Act. * * * And the case will be remanded to the end that notice may be given to creditors of the sale, and proposed confirmation and the application of receiver, commissioner, and counsel for allowance. The court need not order a resale of the property unless after notice to creditors it shall appear that the amount of the bid is grossly inadequate. * * * In making allowances, the limitation of statute referred to and the requirement of General Order No. 42 should be observed."

Butler v. Ellis, supra.

In the case of *In re Einstein,* 245 Fed. 189, at 194, the Court in its opinion said:

"It seems to me this reduces the question in issue to the proposition: Has this court the ancillary jurisdiction or power to establish and declare the existence of this lien, direct its payment from the proceeds of such sale, and also the legitimate expenses of the receiver, and direct the payment of the balance to the trustee in Florida? *Or* must this court, having determined that the proceeds of such sale belong to the estate in bankruptcy of Robert Einstein, direct the payment of the funds to the trustee in Florida and relegate the Gurnsey B. Williams Company and the receiver to the court of bankruptcy in Florida? The amendments of 1910 to the bankruptcy law confer ancillary jurisdiction on courts of bankruptcy where property of the bankrupt may be found. *Fidelity Trust Co. v. Gaskell* (109 Fed. 865) (also citing additional authorities). * * * It seems clear that it

would be unjust for a court in bankruptcy, having the actual possession of the property with different claimants thereto residing in its jurisdiction, to send the property to some other district, it might be thousands of miles distant, and relegate the parties to that court."

Authority to Fix Compensation of Receiver and Attorney for Receiver.

In the case of *In re Isaacson* (C. C. A. 2d), reported in 174 Federal Reporter at 406, a petition in involuntary bankruptcy was filed in the Southern District of New York, and a receiver was appointed; the receiver took possession of two places of business of the bankrupt; thereafter a petition in bankruptcy against the same bankrupt was filed in another district, and adjudication followed.

An order was made under General Order No. 6, by which the proceedings were ordered transferred to the jurisdiction last in point of time. Petitions were presented to the First District Court for allowances for the receiver and his attorneys, to wit, the receiver first appointed, and for the allowance of the accounts of the receiver first appointed. It was contended there was legal error in the first court's fixing the amount of allowance and directing payment thereof. The question of jurisdiction was raised, and the opinion in that case reads:

> "We cannot assent to the proposition that the court which appointed the receiver and for which his services were rendered has not jurisdiction to examine into the nature and extent of those services, and to determine what is a proper compensation therefor. Technically, that court has no jurisdiction to order the receivers appointed *by another court* to make dis-

bursements out of the fund in their hands, and in that particular the order of October 27, 1908, is modified; but the bankruptcy court in the Eastern District will undoubtedly give full faith and credit to the determination of the court in the Southern District as to the value of the services rendered by an officer of that court to that court, and will instruct its own receivers accordingly. * * *" (With the modifications above indicated, the order is there affirmed.) (Italics ours.)

In re Isaacson, supra.

In *Fidelity Trust Co. v. Gaskell,* 195 Fed. 865, at page 874, the Court says:

"The suggestion that such a court may not fix and pay the compensation and expenses of its receiver out of the proceeds of the property he seizes and converts into money under its direction, because the amendment of Section 2 of the Bankruptcy Law or the Act of June 25, 1910, provides that notice to creditors shall be given before the compensation of the receiver shall be fixed, loses its force when it is considered that by the same Act notice to creditors of the sale of the property of a bankrupt's estate is also required to be given. (36 Stats. 412, Secs. 9 and 9½, page 841.) And while this question is not here for adjudication in this case, we are unwilling by silence to intimate any assent to a rule that a court appointing a receiver in the exercise of its ancillary jurisdiction in bankruptcy has not preliminary power to pay the compensation and its legitimate expense out of any funds in its hands belonging to the estate of the bankrupt."

In the case of *Loeser v. Dallas* (C. C. A. 3rd Circuit), 192 Fed. 909, it was held that, as between a district court in Ohio and a district court in the Western District of

Pennsylvania, the Court appointing the receiver had jurisdiction to settle the receiver's accounts, and that the receiver was not bound to account to the court of primary jurisdiction providing notice of the hearing of his accounts was given. The Court said:

> "The amendment of June 25, 1910, to the bankruptcy law, providing for ancillary proceedings in bankruptcy, simply recognized by statute a practice which courts in bankruptcy in pursuance of principles of equity and comity had theretofore generally exercised. In the nature of things an ancillary receiver must be subject alone to and obey the orders of that court of which he is an officer. So obeying, it follows that to it alone he must account. Any other course would breed confusion in administration and go far toward making the exercise of ancillary jurisdiction impracticable; but if a court in pursuance of comity undertakes to exercise ancillary jurisdiction by administering local assets which it alone has power and jurisdiction to administer, it follows that its hand must be free to administer by its own officer and to exact from him the full measure of duty. Such effective work it can only secure from an officer answerable to it alone. *Kirker v. Owings*, 98 Fed. 511, 39 C. C. A. 132; *Sands v. Neely*, 88 Fed. 133, 31 C. C. A. 424; *In re Isaacson*, 174 Fed. 406, 98 C. C. A. 614; *Ames v. U. P. Ry. Co.*, 60 Fed. 966. * * * As this petition has subjected the ancillary receiver to the expense of contesting the petition in this court, the court below is authorized to make such proper reimbursing allowance for such expense to the receiver from the funds in his hands as it deems proper. The order of the district court is affirmed with costs, and the record will be remanded with instructions to that court to allow said costs and a reasonable counsel

fee to the ancillary receiver's counsel for his services in this court, to be paid out of the balance of the monies appearing by his report to be in the hands of said receiver."

Loeser v. Dallas, supra.

Respecting the district courts and their respective territorial limits, the Circuit Court of Appeals for the 8th Circuit, in the case of *Fidelity Trust Co. v. Gaskell*, said:

"Under it these courts must appoint their own receivers, must guard them against wrongful action and consequent liability, and must direct the course that they must pursue. Conscience, good faith, and reasonable diligence alone must move courts of equity to action. They may not be divested of their judicial functions and made mere catspaws to do the will of private parties or public officers even by legislative action, much less by mere construction. * * * That Act and those decisions are that the district courts sitting in bankruptcy and consequently in equity have ancillary jurisdiction in bankruptcy proceedings pending in other districts."

Id.

"A court exercising ancillary jurisdiction acts independently of the court of primary jurisdiction or of its officers, and for itself. It appoints its own receiver, generally the same person appointed receiver by the court of primary jurisdiction, but in the seizure, management, sale and distribution of the property seized within the territorial limits of its district of which it takes the legal custody, this receiver is and must be governed by its orders exclusively."

Id., page 874.

Conclusion.

The order now complained of herein by appellant Jackson does not defy the Oklahoma court. It merely stays its own proceeding in order to complete administration before transmitting its own records to Oklahoma. Whether it is ultimately decided by the Tenth Circuit that California was the primary or secondary jurisdiction makes no difference as to the correctness of the instant correct order requiring the court's own officer to account to it.

It is respectfully submitted that the District Court for the Southern District of California made the only order which it was possible legally for it to make, and in this respect its order should be upheld and the appeal of P. M. Jackson, the Oklahoma trustee, should be dismissed. As was said in the case of *Loesser v. Dallas* (C. C. A. 2nd Cir.), 102 Fed. 909:

> "In the nature of things an ancillary receiver must be subject alone to and obey the orders of that court of which he is an officer. So obeying, it follows that to it alone he must account. Any other course would breed confusion in administration and go far toward making the exercise of ancillary jurisdiction impracticable; but if a court in pursuance of comity undertakes to exercise ancillary jurisdiction by administering local assets which it alone has power and jurisdiction to administer, it follows that its hand must be free to administer by its own officer and to exact from him the full measure of duty. Such effective work it can only secure from an officer answerable to it alone."

And again for the purposes of this brief, we adopt the language as expressed by the Circuit Court of Appeals for the Eighth Circuit in the case of *Fidelity Trust Co. v. Gaskell,* 195 Fed. 865, as follows:

> "A court exercising ancillary jurisdiction acts independently of the court of primary jurisdiction or its officers, and for itself. It appoints its own receiver, generally the same person appointed receiver by the court of primary jurisdiction, but in the seizure, management, sale and distribution of the property seized within the territorial limits of its district of which it takes the legal custody, this receiver is and must be governed by its orders exclusively."

The appeal should be dismissed. Mr. Lynch, the California receiver, as the long arm of the court of his appointment, should account, obey and attorn to the court for which he acts.

Respectfully submitted,

RUPERT B. TURNBULL and
LEONARD J. MEYBERG,
Attorneys for E. A. Lynch, Receiver-Appellee.

No. 9401.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

19

P. M. JACKSON, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a bankrupt,

Appellant,

vs.

E. A. LYNCH, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, alleged bankrupt,

Appellee.

APPELLANT'S CLOSING BRIEF.

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TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

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Appellee.

APPELLANT'S CLOSING BRIEF.

In this, the closing brief of appellant, it becomes necessary to dwell at the outset upon appellee's "Statement of Facts," consisting of the first twelve pages of his twenty-nine page brief.

The factual situation as to the instant matter is set forth in appellant's opening brief and the matters underlying this appeal are set forth in the transcript of the record herein.

Appellee, however, begins his brief by concerning himself with another appeal before this court in which entirely different and other matters of fact and law are involved. Appellant herein will not involve this brief with any attempt to argue the facts or law of that other matter

for obvious reasons; including the reason that the time for filing briefs therein has passed and final briefs are on file.

Appellee has likewise, for example on page 2 of his brief, gone far beyond the record in stating in reference to Woodruff's voluntary petition in Oklahoma:

> "He filed his schedules in bankruptcy in Oklahoma and *did not* list his California properties." (Appellee's emphasis.)

This assertion by appellee is contrary to fact.

Considering further appellee's "Statement of Facts," it is to be noted that on page 2 it is asserted that

> "No receiver or trustee from Oklahoma appeared in California . . . until P. M. Jackson, Trustee, from Oklahoma, appeared in this proceeding with his motion to vacate for the first time on November 17, 1939. . . ."

Lest there be left unanswered any inference or implication from this statement that the trustee (appellant herein) was sitting idly by for months and neglecting his duties, it is but necessary again to refer to the record in this case.

After the adjudication in the voluntary proceeding in Oklahoma and *before* the appointment of Jackson as trustee therein, the petitioning creditor filed his petition in California on July 13, 1939. That petition presented to the California court on July 13, 1939, alleged [R. 8]:

> "That an emergency exists making it absolutely necessary for the appointment of a Receiver . . .

> to take charge of the assets of Leonard J. Woodruff, marshal said assets, preserve the same from loss and destruction or dissipation by the agents of Leonard J. Woodruff, insure the same, and hold the same. . . ."

Upon the qualification of Trustee Jackson in the Oklahoma matter, with an outstanding order by the California court in response to the above mentioned petition, Jackson was placed in an anomalous position in carrying out his duties as trustee for the reason that he could not act, without being in contempt of the California order, until the question was settled.

The assertion, in the face of these facts, is made by appellee on page 8 of his brief:

> "that Trustee P. M. Jackson is the official who left uninsured, uninventoried and unprotected, extensive properties of the bankrupt, real and personal, of a value in excess of $300,000.00, and all on the ground that they were not scheduled in the Oklahoma bankruptcy proceeding."

How, under these facts, appellee can now argue on his line of reasoning in support of his position is beyond understanding.

M. E. Heiser, the sole petitioning creditor in California, appeared and participated in the selection of the trustee in the Oklahoma proceedings wherein appellant herein was elected as trustee. That election was July 20, 1939. [R. 17.]

However, prior to July 20, 1939, and on July 13, 1939, said M. E. Heiser, alone, filed his petition as a creditor in the District Court of the United States, in and for the Southern District of California [R. 3], and procured the appointment of E. A. Lynch as receiver, one week prior to the appointment of P. M. Jackson in Oklahoma. No application was made by Heiser to the Oklohama court for the appointment of a receiver or for ancillary proceedings. E. A. Lynch proceeded to take charge of and insure the bankrupt's property in California before P. M. Jackson was ever appointed, and appellee's argument as to Jackson's alleged inaction in this respect approaches the error of a vicious circle that is more vicious than circular.

The Oklahoma court, without question, assumed jurisdiction on July 5, 1939, and thereafter duly and regularly appointed its trustee, which party is directly responsible to that court for his conduct with respect to the estate.

At this juncture it is necessary to bear in mind that the adjudication on July 5, 1939, in Oklahoma has stood and is at present a valid and uncontroverted judgment, adjudicating Leonard J. Woodruff a bankrupt. No appeal has been taken by any party from that adjudication; nor has any supersedeas bond been filed with respect to the appeal from the order of October 16, 1939. [R. 40 to 42.]

The appeal that is pending before the United States Circuit Court of Appeals for the Tenth Circuit is from the order of the District Court of the United States, in and for the Eastern District of Oklahoma, dated October 16, 1939 [R. 40, 41 and 42], under General Order No. 6 and

from an order of the Oklahoma court denying Heiser's motion to dismiss the proceedings there. This circumstance is a vital fact to be borne in mind throughout the entire consideration of this matter. The question on appeal in the Tenth Circuit is not to determine which proceeding is primary and which is secondary, as is erroneously stated in appellee's brief at page 3. As said by Judge Cosgrave, based upon counsel's own plea in the lower court (App. Br. p. 10):

> "Mr. Lynch, the receiver in California, does not question the effectiveness of the decision of the Oklahoma court, since it was the first to acquire jurisdiction, but he insists that this court must settle his account. . . ." [R. 53.]

Once the Oklahoma court proceeded to judgment on July 5, 1939, it thereby exhausted all concurrent jurisdiction, and the California court had no jurisdiction of either the *res* or person on July 13, 1939, when the involuntary petition was filed in California.

Said M. E. Heiser has, by the proceeding initiated July 13, 1939, in California, attempted to interfere with the orderly processes of administration of the estate by the Oklahoma court, which court had placed *in custodia legis* all of the assets of Leonard J. Woodruff, wherever located, under Section 70, subdivision (c) of the Bankruptcy Act, and in practical effect the California court assumed possession of property then in constructive possession of the Oklahoma court.

The United States District Court for the Eastern District of Oklahoma proceeded, after notice to all parties in interest, to adjudge that that jurisdiction is the domicile of the bankrupt, that the majority of the creditors are there, the bankrupt owns extensive lands there, and that the proceeding there will suit the greatest convenience of the parties. [R. 40 and 41.]

These points are mentioned at the outset to emphasize the fact that appellee begins and proceeds with his brief by dealing with matters that are outside the issue involved in this appeal.

Here, the question is simply whether, under the circumstances, the District Court, in and for the Southern District of California, Central Division, was in error in entering the order of October 19, 1939, staying the transmittal of the records to the District Court for the Eastern District of Oklahoma [R. 40, 41 and 42] and in ordering the receiver, E. A. Lynch, and his attorneys to file their report, and preventing the appellant from taking possession of property belonging to the estate.

Before proceeding to comment upon the several subdivisions of appellee's brief, it is urged by appellant that one important factor be kept in the foreground. Appellee apparently has predicated his position upon the theory that the action of the California court following the filing of the petition by M. E. Heiser on July 13, 1939, resulted in an ancillary proceeding in California.

The Proceeding Is Not and Never Was Ancillary.

General Order No. 51 provides:

> "No ancillary receiver shall be appointed in any district court of the United States in any bankruptcy proceeding pending in any other district of the United States except (1) *upon the application of the primary receiver, or* (2) *upon the application of any party in interest with the consent of the primary receiver, or by leave of a judge of the court of original jurisdiction.* No application for the appointment of such ancillary receiver shall be granted unless the petition contains a detailed statement of the facts showing the necessity for such appointment, which petition shall be verified by the party in interest, or the primary receiver, or by an agent of the party in interest or primary receiver specifically authorized in writing for that purpose and having knowledge of the facts. Such authorization shall be attached to the petition." (Italics supplied.)

Appellant submits that as there was no compliance whatever with General Order No. 51, the whole fabric of appellee's argument falls by reason of that very fact.

The California proceedings were never started or maintained *in aid* of the Oklahoma proceedings, but assumed to be independent and separate proceedings and were in *conflict* with the proceedings in Oklahoma. The Bankruptcy Act, in providing for jurisdiction in ancillary proceedings, specifies in Section 2, subdivision 20, that they shall

> "exercise ancillary jurisdiction . . . *in aid* of a receiver or trustee appointed in any bankruptcy proceedings pending in any other court of bankruptcy." (Italics supplied.)

Attention is directed to the language of the creditor's petition in the California proceedings [R. 9] wherein it is alleged that a receiver need be appointed to take charge of and marshal the assets of Leonard J. Woodruff

> "and hold same until the adjudication and subsequent election of a Trustee in Bankruptcy herein. . . ."

In response to the said petition in California on July 13, 1939, an order appointing receiver was made by the California court containing the following:

> "It Is Ordered That E. A. Lynch of Los Angeles, California, be and he is hereby appointed Receiver of *all property of whatsoever nature and wheresoever located*, now owned by or in the possession of said bankrupt, and of all and any property of said bankrupt and in possession of any agent, servant, officer or representative of said bankrupt, care for, inventory, insure, segregate and move all assets of said bankrupt until the appointment and qualification of the Trustee herein." (Italics supplied.) [R. 12.]

The question of simultaneous proceedings in bankruptcy involving the same debtor is not necessarily an unusual one. Appellee herein has referred to "Remington on Bankruptcy" at pages 13, 14 and 15 of his brief dealing with the subject of jurisdiction.

We refer to the same authority, "A Treatise on the Bankruptcy Law of the United States," by Harold Remington, Fourth Edition Volume 1, 1934, beginning at page 447. At page 448 we find the following textual statement supported by authority:

> "The court making the first adjudication of bankruptcy retains jurisdiction over all proceedings therein

> until the same are closed and may stay the other proceedings."

See, also:

Hamilton Gas Co. v. Watters, 79 Fed. (2d) 438,

which involves appeals from the District Court of West Virginia. Reorganization of a Delaware corporation following petition of debtor corporation in New York, filed June 8, 1934, followed by decree on June 9, 1934, taking exclusive jurisdiction of debtor and its property, which gave that court the prior right to proceed despite the earlier petition filed by creditors on June 7, 1934, in West Virginia. Jurisdiction in New York, based upon the allegation that the principal place of business was there, while jurisdiction was asserted in West Virginia upon the allegation that the principal assets were in West Virginia. It was then held as to this conflict:

> ". . . that it was the intention of Congress to give preference, under such circumstances, to the jurisdiction selected by the corporation debtor rather than that chosen by the petitioning creditors; and that it is the priority of the adjudication not priority in the filing of the petition which determines the right of the court to retain jurisdiction as against another court in which a petition has also been filed."

It was later found as a fact that by reason of the principal place of business also being in West Virginia the proceedings in New York should be dismissed.

Before proceeding to discuss the several following headings of appellee's brief it is deemed to be important to point out appellee's failure to identify accurately his reference to "Remington on Bankruptcy." It is not possible to

determine which edition of that work he may have had before him by the references on pages 13, 14 and 15 of his brief. Examination of the 4th Edition of the work does not check with his citations.

Further, there are incorrect citations to reported cases in appellee's brief; for example, on page 14, *German v. Franklin* is cited 9 Sup. Ct. Rep. 159, 128 U. S. 52, 32 L. Ed. 519. The U. S. reference should be 526 instead of page 52.

Again, on page 28, *Loesser v. Dallas* (C. C. A. 2d. Cir.), 192 Fed. 909, is erroneously cited as being reported in Volume 102.

The cases themselves cited by appellee may be segregated into two general classifications; those treating of ancillary proceedings and the rights, duties and responsibilities of those acting in that capacity; and those cases dealing with other jurisdictional and related matters.

Under the first group of cases, it is submitted, as in this matter clearly appears that the proceedings in California were not ancillary, but in fact were in conflict with the Oklahoma proceedings.

Within the second group of appellee's cited cases are such cases as

Babbitt v. Dutcher, 216 U. S. 102,

cited on pages 16 and 18 of his brief. That case deals with the question of whether the corporate books relate to the property of the bankrupt to the extent that they may be seized by the trustee. That and similar cases are of no assistance in the present problem, which involves a conflict between two district courts for exclusive jurisdiction.

I.

Beginning at page 13 appellee advances a discussion that jurisdiction existed in California by reason of California being the alleged principal place of business and domicile of Woodruff.

There is no dispute upon the general propositions of law set forth by appellee in so far as those propositions apply to a set of facts where the bankrupt has his principal place of business in one jurisdiction and his domicile in another that he may be adjudicated in either, but no case holds that he may be adjudicated in both. The courts in each district have concurrent jurisdiction to start, but when one proceeds to judgment or assumes jurisdiction then the power of the other court is exhausted.

Appellant points out that the very foundation of appellee's argument is non-existent for the reason that the Oklahoma court has determined formally that it has jurisdiction by reason of Woodruff's domicile and principal place of business being in that jurisdiction, and the order of adjudication is a final judgment and not subject to a collateral attack. (See appellee's authorities, p. 14.)

Appellant respectfully refers to the authorities cited in his opening brief, pages 4 to 8, which deal with the character of the real question here involved, and to the California District Court's decision [R. 51] which clearly states the question involved.

Appellee under this part of his brief captions the succeeding discussion by an allusion to the alleged failure of the bankrupt to schedule certain property in the Oklahoma proceeding. That does not appear to be a jurisdictional question in any respect; the record in nowise supports such caption, nor is it a fact that the bankrupt so acted.

The trustee's title to property of the bankrupt does not depend on whether assets are scheduled, nor is there anything in the Act that the scheduling of assets affects the jurisdiction.

II.

On pages 16 and 17 of appellee's brief his argument proceeds upon two different hypothetical theories that the jurisdiction is either primary or ancillary. He apparently is unable to determine which of these assumed theories he should follow.

The answer is plain—the California "jurisdiction" was neither primary nor ancillary, in fact it did not exist.

As pointed out in appellant's opening brief, beginning at page 9, no ancillary proceedings were instituted under General Order No. 51, or otherwise. Again, this point is not in question in the present proceedings. The Bankruptcy Act of the United States and the general orders established by the Supreme Court provide specific, definite and orderly proceedings and steps in cases of ancillary proceedings to preclude the very anomaly that threatens in this matter by reason of two district courts attempting to assume jurisdiction of the same subject matter at the same time. Were such a situation possible, it is conceivable that a bankrupt, merely by reason of owning property in several jurisdictions, would find his estate subject to multiple proceedings all over the United States. That possibility and its consequent defeat of creditors' rights is the obvious reason for General Order No. 51 and Sections 2-a, subdivisions 20 and 69, subdivision c of the Bankruptcy Act. See record, page 54, where the order of the California court plainly states its jurisdiction is not ancillary.

III.

Beginning at page 18 appellee discusses generally a proposition of law that does not involve the facts of the case here at issue. Discussion is there indulged in by appellee concerning the rights of courts in *ancillary* proceedings.

Appellant is not controverting any assertions as to the powers of courts in true ancillary proceedings, but respectfully points to the obvious fact that the instant matter does not involve ancillary administration. As stated, the authorities cited by appellee do not apply to the facts of the instant matter.

IV.

Appellee, beginning on page 21, continues his discussion upon the theory that the instant matter arises out of ancillary administration.

By applying the very argument advanced by appellee at this point it is apparent that the Oklahoma court has jurisdiction of the estate to the exclusion of all other courts. Examination of the situation dealt with in

In re Continental Coal Corp., 238 Fed. 113

discloses a great similarity to the case here at issue and the holding is to the effect the court—such as the Oklahoma court in this matter—has such possession of the estate, as placed it in *custodia legis*. (See pages 4 to 8, appellant's opening brief.) Appellee apparently overlooks the fact that the possession of the property by the Oklahoma court may be actual or constructive, and no court, state or federal, may interfere.

Isaac v. Hobbs, 282 U. S. 734.

V.

At page 24 and following appellee further argues upon the theory of ancillary administration in California. Appellant again must advert to the fact that the argument of appellee is outside the point at issue. Under the circumstances of the instant matter, in order to proceed with ancillary administration compliance with General Order No. 51 would have to have been had, and the proceeding must be instituted *in aid of* and *not in conflict with* the Oklahoma administration.

Were that done, then there would be a wholly different situation here involved as to the power of the California court to fix the compensation of its appointee for services rendered in the interests of the estate. However, there was no such proceeding had, all of which is unequivocally supported by the record herein and even the order of the California court. [R. 54.]

VI.

In concluding the closing brief of appellant, it is respectfully pointed out that appellant's opening brief sets forth clearly and tersely the factual situation; deals with the legal propositions involved and states appellant's position.

Appellee has devoted practically all of his brief not by way of reply to a single case cited by appellant, but indulges in a discussion of law applying to other and different factual situations. Appellant fails to see the applicability of any of the points or cases advanced by appellee since they relate to ancillary proceedings and for that reason appellant is not analyzing in detail the cases cited by appellee.

In conclusion these following points are made for emphasis which, it is submitted, definitely support appellant's position that the orders appealed from should be set aside:

A. Voluntary petition filed in Oklahoma July 5, 1939.

1. Oklahoma court thereby acquired exclusive jurisdiction.
2. No ancillary proceedings were had at any time.
3. Jurisdiction of other courts of concurrent jurisdiction was thereupon exhausted.
4. No appeal taken from the Oklahoma adjudication of July 5, 1939.

B. Involuntary petition filed in California July 13, 1939, by a single petitioning creditor (M. E. Heiser), who had actual knowledge of the Oklahoma adjudication and, without applying to that court for ancillary proceedings, instituted an involuntary proceeding in California and in *conflict* with Oklahoma court, *not in aid thereof.*

C. Heiser, the California petitioning creditor, appeared in the Oklahoma proceeding and participated in the election of the trustee, appellant herein.

D. After hearing, upon notice to all interested parties, the Oklahoma court found and determined that the appointed trustee should assume and take exclusive possession of all property wherever situated, and that all future proceedings should be had in that court.

E. As in this brief hereinabove pointed out, the question here involved is the propriety of the action of the District Court of California staying the execution of the order of October 18, 1939 [R. 40, 41 and 42] of the Oklahoma court; and as to the propriety of the order of October 19, 1939 [R. 43 to 46 incl.] and of November 15, 1939 [R. 51 to 55 incl.] made by the California court.

There is yet another and eminently practical consideration applying to this case. The underlying theory of bankruptcy is to preserve the assets of the estate for the benefit of the creditors. To accomplish that equitable objective it is essential to minimize expenses and costs and above all to avoid duplication of expenses.

Should appellee's theory be upheld in the instant matter thereupon the precedent is established that following adjudication of a bankrupt that owns property or has places of business in many jurisdictions, instead of a single court administering the estate there could well be scores of receivers in every district where property might be situated all clamoring for compensation to the several courts of their appointment. Allowances could be made in many jurisdictions without regard to the statutory limitations on receiver and trustee compensation.

(Sec. 48 of the Bankruptcy Act as amended.)

Representative attorneys from many jurisdictions might converge upon the court of adjudication (to ascertain the amount of insurance to be carried), all of which

would melt the estate away to the vanishing point. Such a situation is unthinkable.

In the instant matter the appellee has no cause for complaint because the existing circumstances are entirely the result of one court and its agents endeavoring to take property already in *custodia legis* of another court.

It is finally urged, upon the record herein, and upon the authorities cited by appellant here and in his opening brief that the orders appealed from be set aside to the end that the administration of the estate of the bankrupt may be carried on in an orderly fashion by the court having exclusive jurisdiction thereof, namely, the District Court of the United States for the Eastern District of Oklahoma.

Respectfully submitted,

FRANCIS B. COBB,
Attorney for Appellant.

No. 9401.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

21

P. M. JACKSON, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a Bankrupt,

Appellant,

vs.

E. A. LYNCH, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt,

Appellee.

PETITION FOR REHEARING.

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Parker & Baird Company, Law Printers, Los Angeles.

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TABLE OF AUTHORITIES CITED.

Cases.

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No. 9401.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

P. M. Jackson, Trustee in Bankruptcy for the Estate of Leonard J. Woodruff, a Bankrupt,

Appellant,

vs.

E. A. Lynch, Receiver in Bankruptcy of the Estate of Leonard J. Woodruff, Alleged Bankrupt,

Appellee.

PETITION FOR REHEARING.

To the Honorable Circuit Court of Appeals of the United States in and for the Ninth Circuit:

Comes now P. M. Jackson, trustee in bankruptcy for the estate of Leonard J. Woodruff, a bankrupt, appellant, and herewith petitions the above-entitled Court for a rehearing herein upon the following grounds:

I.

The opinion of this Court fails to give full faith and credit to a final judgment of the District Court of Oklahoma.

II.

The opinion of this Court is in conflict with and violates the spirit and letter of the United States Supreme Court's General Order No. 6.

III.

The opinion of this Court is in conflict with and violates the spirit and letter of the United States Supreme Court's General Order No. 51.

IV.

The opinion of this Court is erroneous in holding that the District Court of California had primary jurisdiction after the entry of the order of adjudication by the District Court of Oklahoma.

V.

The opinion of this Court in defining "Jurisdiction" fails to state to what time concurrent primary jurisdiction exists or when it is exhausted as between the District Court of Oklahoma and the District Court of California.

VI.

The opinion of this Court is erroneous in holding that the District Court of California continued to have primary jurisdiction after a court of concurrent jurisdiction had proceeded to final judgment.

VII.

The opinion of this Court is erroneous in applying the principle in the case of *Jones v. Springer,* 226 U. S. 148.

VIII.

The opinion of this Court is erroneous in assuming that the action of the District Court of California (in conflict with the District Court of Oklahoma) was proper by reason of a lack of a custodian of the bankrupt's property, where the Bankruptcy Act provides ample powers by ancillary proceedings in aid of the court of original jurisdiction.

IX.

The opinion of this Court is erroneous in holding that applying to the District Court of California for an order to turn over the property in California to appellant was the exercise of ancillary jurisdiction in bankruptcy.

Introduction.

Appellant feels that the decision of this Court on which a rehearing is requested is contrary to the settled principle of the Bankruptcy Act pertaining to jurisdiction of courts of bankruptcy, and will encourage in the future needless receiverships, and will duplicate proceedings in bankruptcy and the administration of estates and, in the public interest, the decision of this Court should be changed in harmony with the decisions of this Court and the Supreme Court.

According to our understanding of the law the decision in the instant case violates the following principles of law:

(1) That where two courts have concurrent jurisdiction, and the first of said courts proceeds to judgment,

the other court must give full faith and credit to the previous judgment, and nothing is left, over which the second court can exercise jurisdiction.

(2) That no proceedings in another district can be instituted except as provided by Section 69, Subdivision C, and Section 2-A, Subdivision 20, of the Bankruptcy Act (11 U. S. C. A., par. 11, Subdivision 20), and General Order No. 51, and the Act requires them to be in aid of the primary court, and not in conflict therewith.

(3) That a motion or suggestion to a court lacking jurisdiction cannot confer jurisdiction, or make the proceedings ancillary, but is a judicial courtesy which should first be resorted to, as suggested by the Supreme Court in *Gross v. Irving Trust Co.,* 289 U. S. 342, 345.

(4) The Court's decision leaves an uncertainty as to whether the proceedings in the District Court of California are ancillary or whether it is a primary proceeding (it cannot be both), which will lead to further confusion and litigation in respect to fees, ownership and control of property, as well as other matters.

We submit the following argument in support of this petition for rehearing.

ARGUMENT.

Failure to Give Full Faith and Credit to a Final Judgment.

No appeal having been taken from the order of adjudication entered by the Oklahoma District Court, said order became a judgment *in rem* against all creditors and other parties in interest, and removed the title to the bankrupt's property to the custody of the District Court of Oklahoma.

Gross v. Irving Trust Co., 289 U. S. 342, 344.

The rule is tersely stated in *Gilbert's Collier on Bankruptcy*, 4th Edition, page 417, as follows:

> "An adjudication acts both *in personam* and *in rem*. The property of the bankrupt at once vests in the trustee subsequently to being appointed; remaining meanwhile *in custodia legis*. All persons named in the schedules as creditors are parties and affected thereby." Citing *Robertson v. Howard*, 229 U. S. 254.

We submit that to give full faith and credit to said judgment of adjudication no other court could thereafter enter another judgment of adjudication attempting to pass title to the bankrupt's assets at a different date to a possible different trustee. Such a construction leads to confusion and, we submit, is not the law.

We feel that the decision of this Court is erroneous in not distinguishing between the jurisdiction of courts of bankruptcy, first, to enter an order of adjudication; second, to administer assets and distribute the same to creditors; third, to entertain ancillary proceedings; and fourth, to entertain suits to recover preferences, etc., authorized under Section 70, Subdivision 3, of the Act.

Appellant does not dispute the fact that proceedings might be instituted in a number of District Courts in connection with the prosecution for crimes; entertaining plenary actions; in fact, Section 2 of the Bankruptcy Act, Title 11, Section 11, U. S. C. A., specifies some twenty-one subdivisions under which courts of bankruptcy have jurisdiction, but to give said section the interpretation given by this Court would mean that said jurisdiction once existing should exist forever, in spite of a previous final judgment by one of the courts of concurrent jurisdiction. An example would be that, under Subdivision 4 of Section 2 of the Act, all District Courts have jurisdiction

> "to arraign, try and punish persons for violation of this Act in accordance with the laws of procedure of the United States now in force . . ."

It cannot be contended that if such a person were tried and punished in Oklahoma on a violation of the Bankruptcy Act, where concurrent jurisdiction was originally in the District Court of California, that after proceeding to judgment of conviction in Oklahoma, said person could be tried for the same offence by the District Court of California. Subdivision 8 of Section 2 of the Act provides:

> "close estates by approving the final accounts and discharging the trustees whenever it appears that the estate has been fully administered."

Certainly the District Court of California would have no jurisdiction to close the estate and discharge the trustee and end the bankruptcy proceeding in Oklahoma.

We submit that under the decision of this Court construing Subdivision 1 of Section 2, permitting a proceeding in the District Court of California after a final judgment in Oklahoma, would permit the California Court to enter a judgment of adjudication, appoint a trustee and proceed to confuse the administration of this estate, and approaches a far more absurd proposition than the two examples hereinabove stated.

We submit that this Court's decision should be changed wherein it recites:

> "until consolidation was ordered by the District Court for the Eastern District of Oklahoma, both of these courts had primary jurisdiction to entertain petitions in bankruptcy, appoint receivers and do whatever was necessary to preserve the bankrupt's property"

to read:

> "until the entry of the order of adjudication in the District Court of Oklahoma, the District Court in Califonia had concurrent jurisdiction with the District Court of Oklahoma to entertain voluntary or involuntary petitions to adjudge Leonard J. Woodruff a bankrupt, but after the Oklahoma Court, in exercise of its jurisdiction, had proceeded to final judgment, the District Court of California must give full faith and credit to said judgment, and its concurrent jurisdiction was thereupon exhausted to enter an order of adjudication or to entertain a petition for such an order, but said California Court then had jurisdiction only to entertain ancillary proceedings properly instituted under General Order No. 51 for the appointment of a receiver in aid of the Oklahoma Court."

The Opinion of This Court Violates the Spirit and, We Think, the Letter of General Order No. 6.

Attention is called to General Order No. 6 providing that, upon application being made, the Court first acquiring jurisdiction shall

> "determine the court in which the cases can proceed with the greatest convenience to parties in interest, and the proceedings upon the other petitions *shall be stayed by the courts in which such petitions have been filed until such determination is made.*" (Emphasis supplied.)

We think the spirit as well as the interpretation of this order means that no further steps should be taken to settle receiver's accounts or perform other duties by any court until the conflict between the respective courts has been determined, and then, no provision being made for further orders or proceedings in any other court, the order is mandatory that the other courts shall order the cases before them transferred to the court first acquiring jurisdiction.

Under the opinion of this Court this General Order can be made meaningless by allowing the other courts to proceed to enter orders for fixing fees, ordering the fees paid, ordering sales of assets, etc., and there is no end to where the confusion and proceedings may lead, while a reasonable interpretation of the General Order would mean that all other courts must immediately transfer the file and proceedings to the court first acquiring jurisdiction, so that said General Order and its useful purposes and objects can be accomplished.

May we inquire, what benefit is the injunctive provision "shall be stayed" if after the order is made under General Order No. 6 the "stay" is dissolved and the court enjoined is allowed to enter further orders?

The Opinion Violates the Spirit and Mandatory Provisions of General Order No. 51.

The next to the last paragraph of the decision by this Court is to the effect that the application by Jackson to the District Court of California for surrender of the property retroactively converted the proceedings in California into ancillary proceedings and was an exercise by the California Court of ancillary jurisdiction.

The Supreme Court, in *Gross v. Irving Trust Co.,* 289 U. S. 342, 344, has stated that this proceeding should be followed under a judicial courtesy owed by one court to another. The Court stated:

> "Nevertheless, due regard for comity — which means, in this connection, no more than judicial courtesy between the courts undertaking to deal with the same matter—would suggest that ordinarily the trustee in bankruptcy might well be instructed by the bankruptcy court, before taking final action, to request the state court to recognize the exclusive jurisdiction of the former and set aside any orders already made conflicting therewith, as was done with good results in the case of *In re* Diamond's Estate, *supra,* pp. 72, 75. In the present case, however. such a course would probably have been futile, in view of the fixed attitude of the state courts on the subject."

This Court, in *Moore v. Scott,* 55 Fed. (2d) pages 863, 864, laid down the rule:

> "Nor can the bankruptcy court itself surrender this exclusive jurisdiction: '"Indeed, a court of bankruptcy itself is powerless to surrender its control

> of the administration of the estate." ' Isaacs v. Hobbs Tie & T. Co., 282 U. S. 734, 739, 51 S. Ct. 270, 272, 75 L. Ed. 645."

If the court of primary jurisdiction could not waive or surrender its jurisdiction, it certainly would not, by practising the judicial courtesy suggested by the Supreme Court, create an ancillary proceeding in California and confer upon the California court the right to administer the bankrupt's assets. Furthermore, the Supreme Court, by its General Order No. 51, in mandatory language, provides:

> "No ancillary receiver shall be appointed in any district court of the United States in any bankruptcy proceeding pending in any other district of the United States except (1) upon the application of the primary receiver, or (2) upon the application of any party in interest with the consent of the primary receiver, or by leave of a judge of the court of original jurisdiction. . . ."

Since the proceedings filed in California were not claimed to be ancillary, nor did the lower court consider them ancillary proceedings, nor has anyone contended that General Order No. 51 has been met or complied with, we feel that the language used by this Court in the next to the last paragraph should be eliminated or changed in accordance with the rule announced by this Court in *Moore v. Scott, supra,* and in accordance with General Order No. 51.

In *United States Code Annotated,* 1939 Supplement, Title 11, Sections 1 to 31, there is a commentary on the Chandler Bill by George E. Q. Johnson, former United

States district judge and author of *Johnson's Bankruptcy Reorganizations.* Quoting from page 8, the author states the rule contended for by appellant:

> "In ancillary proceedings, however, the judge may appoint one or more ancillary receivers, and to prevent unseemly controversies between primary and ancillary receivers, and between the courts of primary and ancillary jurisdiction, the judge must appoint a primary receiver as an ancillary receiver, although he may appoint one or more co-ancillary receivers. This new provision prevents local creditors from controlling the ancillary proceedings antagonistically to the primary receivership and thus a unified administration free from expensive and delaying jurisdictional controversies is made possible."

Application of Babbit v. Dutcher.

This Court cites the case of *Babbit v. Dutcher,* 216 U. S. 102, and we desire to call attention in respect to the language of the Supreme Court in deciding the matter that the case arose by an ancillary proceeding instituted on the application of the receiver appointed by the court of primary jurisdiction, and we submit the language of the Court should be considered in construing that set of facts, together with the further fact that the statute and General Orders have since been amended by the amendment of 1910 to Section 2, Clause 20, of the Bankruptcy Act (see *Lazarus v. Prentice,* 234 U. S. 263, 267); also before the promulgation of our present General Orders Nos. 6 and 51, and before the enactment of the Chandler Act. The Court, in construing the powers of courts of bankruptcy, did not lay down the rule as to how those powers are invoked or when concurrent jurisdiction was exhausted.

The Court Erred in Applying the Case of Jones v. Springer.

This Court cites the case of *Jones v. Springer*, 226 U. S. 148, as an authority in support of the statement of this Court that

> "the District Court for the Southern District of California had power to do all that it did in this case when acting upon a petition in bankruptcy, notwithstanding a prior adjudication."

The distinguishing facts in *Jones v. Springer* from the question at bar are:

(1) The property was placed *in custodia legis* of the state court prior to bankruptcy;

(2) The property was perishable and it was necessary for a sale to be made to preserve the *res;*

(3 The claim of the trustee was transferred to the proceeds, which were merely substituted for the property;

(4) There was no attempt to reduce the amount of the *res* by fixing fees;

(5) The parties acted in good faith, without knowledge of the adjudication in bankruptcy;

(6) Transactions without knowledge of the bankruptcy are recognized as valid in the absence of fraud or lack of consideration under Section 21, Subdivision g of the Bankruptcy Act itself.

The language contained in the opinion of this Court in respect to *Jones v. Springer* violates the rule stated by this Court in *Moore v. Scott, supra,* wherein a department of the District Court appointed a receiver (and we assume an emergency existed justifying the appoint-

ment), and the District Court was in possession of the assets prior to the filing of the petition in bankruptcy, and the District Court made an order fixing fees and providing for their payment, which order this Court set aside upon principles suggested by appellant in briefs on file in this Court. The Court said:

> "To say that the judge of the court sitting in equity could protect the rights of all parties as well as could be done if he were sitting in bankruptcy is beside the question. Congress has provided for the administration of bankrupt's estates in the bankruptcy court; and after a bankruptcy has supervened, no other court has the power or authority partially to administer or to deplete the estate, by disposing of or impressing a lien upon it or upon any part thereof—valid prior liens, of course, excepted—not even in favor of its own receivers."
>
> *Moore v. Scott, supra.*

Lack of a Custodian in California Conferred No Jurisdiction.

The portion of this Court's decision based upon the theory that it was necessary for the District Court in California to take possession of property within this district in order to protect the same from loss, or that it might have been destroyed if left for a single day without a custodian, finds no support in the record, and appellant feels that the exposure of the property which was *in custodia legis* and which the world was on notice of by recordation of a copy of the order of adjudication in

California, on July 7th, 1939 [Tr. p. 17] Sections 44 and 75, Title 11, U. S. C. A., was not nearly so dangerous as the hazard to which the estate is now exposed by the petitions for some $17,500.00 in fees by the unjustifiable proceedings in California.

The creditors in California could easily have provided proper protection in the event of the danger of loss (1) by proceedings instituted under General Order No. 51, applying for an ancillary receiver with the consent of the District Court of Oklahoma; (2) by the levy of a writ of execution on the judgment of the petitioning creditor; (3) by applying, under Section 2, Subdivision 3 of the Bankruptcy Act, for the appointment of a custodian, United States marshal, or receiver, to the Court that had jurisdiction of the assets.

We feel that it is a dangerous doctrine to confer jurisdiction on courts beyond the statute and in violation of a General Order in Bankruptcy on the theory of an emergency and that, unless this portion of the decision is changed, abuses are sure to develop in the future, and an alleged emergency will be offered as an excuse for the failure to follow the law and General Orders in Bankruptcy, which will lead to confusion in the administration of bankruptcy estates. The procedure contended for by appellant is in harmony, we think, with Section 32 of the Bankruptcy Act (Section 55, Title 11, U. S. C. A.), as well as General Order No. 6.

Correction of Facts.

This Court states in the closing sentence of its opinion that the papers were transmitted by the District Court of California to the District Court of Oklahoma. An examination of the records made by counsel as of this date shows that no certified copies or documents have been transmitted as provided in General Order No. 6, and we respectfully submit that appellant is entitled to have the opinion corrected to show that said records have not been transmitted by reason of the restraining order appealed from by appellant herein.

Since this Court's opinion filed May 10th, 1940, the United States Circuit Court of Appeals for the Tenth Circuit has decided both of the appeals against the appellant's therein, so that the Order entered by the Oklahoma Court under General Order No. 6, as of October 16th, 1939 [Tr. pages 40 to 42 inclusive], has been held by the Circuit Court for the Tenth Circuit to be proper, and has also affirmed the District Court's order denying the motion of M. E. Heiser, the petitioning creditor in the above entitled proceedings, to dismiss the proceedings in Oklahoma. That said appeal is entitled *M. E. Heiser and George F. Fowler v. Leonard J. Woodruff, et al.*, No. 2024. We ask the Court to consider the opinion of the United States Circuit Court of Appeals for the Tenth Circuit in connection with this Petition for Rehearing, and to amend the Statement of Facts contained in the opinion accordingly. That counsel has not had the benefit of a copy of the opinion of the Circuit Court for the Tenth Circuit at the time of the filing of this petition for rehearing, and asks this Court to consider the same in connection with this Petition for Rehearing.

Conclusion.

In conclusion we submit that the decision of this Court should be changed to be in harmony with *Moore v. Scott, supra,* and *Gross v. Irving Trust Co., supra,* and that this Court should state clearly the time which concurrent jurisdiction exists and terminates between the respective District Courts in bankruptcy in respect to adjudging persons to be bankrupt, and to distinguish between jurisdiction to adjudge a person bankrupt, and jurisdiction to administer his estate, and to entertain other proceedings authorized under Section 2, Subdivisions 1 to 21, of the Bankruptcy Act. That this Court should eliminate the application of *Jones v. Springer* to the case at bar, and should decide definitely whether the proceedings are ancillary or primary.

Respectfully submitted,

FRANCIS B. COBB,
Attorney for Appellant.

Certificate of Counsel.

The undersigned, Francis B. Cobb, counsel for appellant herein, does hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay and is, in my judgment, well founded.

FRANCIS B. COBB.